



INSTITUTE FOR DEFENSE ANALYSES

Analysis of Employer Costs from Reserve Component Mobilization

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December 2004
Approved for public release;
distribution unlimited.
IDA Paper P-3872
Log: H 04-002292

This work was conducted under contract DASW01 04 C 0003, Task BE-6-2308, for the Office of the Assistant Secretary of Defense (Reserve Affairs). The publication of this IDA paper does not indicate endorsement by the Department of Defense, nor should the contents be construed as reflecting the official position of that Agency.

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PREFACE

The Institute for Defense Analyses (IDA) prepared this paper for the Office of the Assistant Secretary of Defense (Reserve Affairs) under a task entitled “Analysis of Costs to Employers Due to RC Mobilizations.” This paper examines the available information about the costs that mobilizations impose on employers, recommends a survey of employers to fill out gaps in available information, and discusses options for mitigating those costs.

The authors wish to thank IDA colleagues David Graham, Stanley Horowitz, and James Wilson as well as members of the Reserve Affairs staff for their constructive comments on an earlier draft of this paper.

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SUMMARY

The increased frequency of Selected Reserve unit mobilizations has increased the number of civilian employers losing employees to extended Reserve deployments. The loss of these employees may impose significant costs on employers, and it may be beneficial to offset some of these costs to avert reductions in employer support that could affect the retention of members of the National Guard and Reserve. It is likely that the cost consequences are different for small employers than for large ones. Limited evidence suggests that the most significant costs for small employers are related to lost productivity and sales rather than to the costs associated with the requirements imposed by the Uniformed Services Employment and Reemployment Rights Act (USERRA).

USERRA imposes certain direct financial costs on employers. When a reservist employee is demobilized and returns to work with the same employer, the employer must contribute to the reservist's retirement account what the employer would have contributed had the reservist not been called up. Based on published civilian age-group and firm-size specific data, we estimate that 50 percent to 58 percent of employed reservists participate in an employer-provided retirement plan, and that the employer cost for a reservist's retirement plan averages \$372 per month. Public sector employers are most likely to contribute and they contribute more than average. Small employers are least likely to contribute and those that do contribute less than average.

Employers of reservists ordered to active duty for 30 or fewer days must continue their normal health insurance contributions. Again based on published civilian age-group and firm-size specific data, we estimate that roughly 65 percent of reservists participate in an employer-provided health insurance plan, and the monthly employer cost averages \$215 for singles and \$550 for families.

Reservists returning from active duty have the right to return to their previous positions or equivalent ones, and to receive accumulated seniority raises and promotions. This requirement causes employers to bear the costs of temporarily replacing their reservist employees, to the extent they choose to do so, but no data on this exist. Another federal program with similar requirements is the Family and Medical Leave Act (FMLA), which allows employees 12 weeks of unpaid job-protected leave with medical coverage.

Surveys have found that 41 percent of firms report that they hired temporary replacements, but fewer than 10 percent of firms report that their hiring and training costs increased by more than small amounts. Roughly 88 percent of employers reported that FMLA had no noticeable effect on profitability, while 10 percent reported a negative effect. And many employers provide pay and benefits beyond what is legally required of them for employees on leave to care for newborns, just as many employers do for their activated reservists.

The long-run effects of activating reservists may be greatest for small businesses, where the loss of an employee constitutes a greater share of a firm's output. We interviewed a small number of recipients of Small Business Administration Military Reservist Economic Impact Disaster Loans (MREIDL). This group was not a random sample of small firms; instead, it was selected precisely because these firms suffered serious economic consequences. We found that the most common effect of activation is lost business and that losses are experienced even after the reservist returns from active duty. Replacing the reservist, even if feasible, does not necessarily offset lost business. In some instances, the long-run effect of activation may permanently cripple the business. On the other hand, USERRA-related costs did not seem to be important factors for these small firms.

Thus, we know that some employers may bear sizeable USERRA-related financial costs and that some other, smaller firms may suffer business losses sufficient to put their economic viability at risk. We do not know how many employers and which industries bear significant costs. And we don't know how much these costs are offset by the value reservists bring to their employers because of their military backgrounds. We recommend surveying a sample of employers representing a broad cross-section of mobilized reservists' employers to fill in these knowledge gaps. In particular, the survey should cover:

- Financial costs, including USERRA-mandated pension and health care costs, costs of replacement and retraining, business losses
- Company adjustments, including lost workload, additional production costs, effects of duration of active duty, effects on other employees' morale and productivity
- Experience with reservist employees, including value of military training and discipline, character traits associated with success in military, commitment to shared values

There are two reasons to consider offsetting the costs borne by the civilian employers of mobilized reservists. The first is that these costs may, despite law to the contrary, cause some employers to discourage their employees' Reserve participation or deter them from hiring reservists. The second is that mobilized reservists' employers may unfairly bear a disproportionate burden for the national defense, even if the employers' treatment of their reservist employees is not affected.

The effectiveness and administrative expense of different cost-mitigating options depend on how much costs vary within identifiable categories of employers. In general, the options with the lowest administrative expenses may also be the least effective. For example, a very low administrative cost approach would be to compensate employers for health and pension benefits at a fixed rate per day of their employee's active military service, with the payments based on national averages for health insurance premiums and pension contributions. This would treat all employers equally. But employers with higher costs would have smaller shares of their costs reimbursed, while employers who do not provide health or pension benefits might be overcompensated. Arguably the most effective approach would be to reimburse employers for their actual losses, but the administrative costs associated with employers determining these costs and with government audits to verify them would be prohibitive. There are intermediate options between these two extremes; their costs and effectiveness depend on the extent to which different categories of costs differ among employers of similar size and industry.

A very different approach to mitigating costs would be for the federal government to offer compensation or reimbursement to those employers whose long-run viability is most threatened by Reserve call-ups. A program like this, possibly modeled after the MREIDL program, would provide an avenue of recourse for companies at risk for substantial long-run losses not covered by other offsets.

I. INTRODUCTION

Increasing reliance on members of the Selected Reserve as participants in military deployments has led to a substantial increase in the average number of deployed duty days per Selected Reserve member since the mid-1980s. Since 1990, virtually every military operational deployment has required the mobilization of Selected Reserve personnel, either to support or complete units deployed abroad or to backfill vacancies in the continental United States (CONUS) created by the deployment of units in the Active component.

This increased reliance on the Selected Reserve to participate in a wide range of military deployments has changed the routine expectations of reservists, their families, and their employers. A broad cross-section of reservists has by now experienced mobilizations lasting 6 months, a year, or even longer. Their families are increasingly dependent on the pay and benefits that accompany military service. And their employers face a much greater likelihood of losing their personnel to extended Reserve deployments.

These considerations do not change very much in the case in which the activated reservist is self-employed. Although a self-employed individual bears all of his business risks himself and thus might be judged to have weighed the risks of Reserve participation against its benefits, changes in expectations apply to the self-employed as well as to other reservists. Moreover, there are some indications that self-employed small businessmen and sole proprietors are most at risk from Reserve activation.

All of these consequences raise questions about the future of Reserve recruiting and retention. If the Selected Reserve is to remain an integral part of U.S. military capability, family and employer support must remain strong in the face of the increasing demands placed on reservists. This paper addresses one of these issues, the costs imposed on employers by Reserve mobilizations and the possibility of mitigating or offsetting some of those costs. Our objective is to identify the kinds of effects that Reserve mobilizations impose on employers, to discuss alternative approaches to mitigating those effects, and to set forth an approach to discovering the magnitude of the

financial and business impacts that employers experience when their reservist employees are called to active duty.

Frequent and lengthy call-ups may impose significant costs on employers, and it may be beneficial to offset some of these costs to avert reductions in employer support that could affect the retention of Guard and Reserve personnel. In principle, costs that mobilizations impose on employers might include straightforward economic costs (pensions, health care) as well as effects including uncertainty, diminished productivity, and employee morale. Among the ways of offsetting such effects are direct compensation, tax credits, subsidization of programs like pensions and health care, and more indirect means such as assistance in hiring replacement personnel.

The Department of Defense needs information about the costs that mobilizations impose on employers and the options for mitigating those costs. The goal of this project is to develop a methodology for collecting information about the costs that mobilizations impose on employers of Reserve component personnel and to evaluate various approaches to offsetting those costs.

II. TYPES OF COSTS IMPOSED ON EMPLOYERS

Losing their reservist employees to military deployments might be expected to affect employers in a variety of ways. *Direct financial costs* include the continuing benefits paid to reservists as mandated by law, and whatever additional pay and benefits employers choose to provide. *Replacing reservists* imposes other costs, and even if employers elect not to replace their reservist personnel they may be affected during their absence. Finally, *long-run effects* upon employers may continue for many months after the return of Reserve personnel.

A. DIRECT FINANCIAL COSTS

Under the Uniformed Services Employment and Reemployment Rights Act (USERRA), employers are required to provide certain benefits to their reservist personnel who are called to active duty. Thus, the law mandates that employers continue to provide benefits to reservists while they are serving, even though they are not generating income for the employer. Some employers elect to go beyond statutory requirements, giving their reservists additional assistance during their periods of military service.

The size and type of costs incurred will vary with the employer's situation. Mandated benefits will only be paid by employers if they regularly pay health and pension benefits to their employees. Therefore those costs are more likely to be paid by large firms and by public-sector employers than by small firms. Those costs would increase with the length of a reservist's absence, and with the number of employees called up.

A similar pattern is likely to hold for non-salary benefits voluntarily paid in addition to those mandated by USERRA, but those costs will be paid only by a subset of those employers that pay mandated benefits. In addition, voluntary benefits are likely to be paid only by employers in good financial health.

Retirement Benefits. Upon a reservist's return from active duty, an employer must pay into the employee's retirement account what the employer would have paid had the reservist not been on active duty if the reservist contributes his share of contributions, if any, to the company's retirement plan. Some companies with such retirement plans elect to provide the employee's matching contribution for some period during activation.

Health Benefits. An employer must maintain an activated employee on the rolls of the company health plan when the orders for active duty are for periods not exceeding 30 days. Some companies elect to maintain health care coverage for their employees for longer periods.

Pay During Activation. When they are called to active duty, reservists are paid according to their military rank and seniority. USERRA does not mandate that employers supplement military pay for mobilized reservists. Nonetheless, many reservists may experience some loss of income when called to active duty, and some companies elect to pay their employees a portion of the difference during the period of activation.

Guaranteed Return. After their completion of active service, reservists are entitled to return to their previous jobs or equivalent ones, and to receive accumulated seniority raises and promotions. This requirement affects the behavior of employers in two ways: they incur costs of additional pay and benefits, and they must consider the eventual return of the reservists when deciding how to deal with their absence during military service.

B. REPLACEMENT COSTS

Although reservists are guaranteed the right to reemployment, a company may elect to replace them during their periods of active duty. In doing so, the company may incur various costs associated with the search for candidates and the hiring process itself, costs of training replacement personnel, and the pay and benefits of the replacements.

Replacement costs are likely to be borne by employers of all types. However, those costs may be higher for small firms that hire only infrequently than for large firms that have dedicated Human Resource departments and thus can realize economies of scale in their search and training efforts. Those costs may also depend on the occupation of the reservist employee. Certain occupations may be in higher demand and shorter supply in the labor market, necessitating a greater and more costly search effort.

Replacement costs will also depend on the length of service in complex ways. When a reservist serves his annual 2 weeks on active duty for training, his employer is likely to treat the activation in the same way as a 2-week employee vacation that does not require the replacement of the reservist. In contrast, a 6-month activation is much more likely to require the employer to find a replacement, even if doing so imposes search and hiring costs. If the reservist is then kept on active duty for an additional 6 months,

however, replacement costs may be low because a replacement has already been found and trained. Thus there is potentially a hump-shaped relationship between replacement costs and length of service.

Hiring Costs. A company replacing its reservists may incur costs of some amount for a variety of activities: advertising for applicants, fees paid to employment agencies, and labor associated with processing applications. In addition, a company might experience enough of a workload increase in its hiring functions to require additional administrative personnel. Even if additional personnel are not needed, a company's regular administrative staff might generate overtime costs.

Training Replacement Personnel. Depending on the skill level of the reservist and the requirements of his position, companies might have to provide either on-the-job or classroom training for replacement personnel. Classroom training can be considered a financial cost, but on-the-job training may be harder to measure. It includes both the labor cost of the replacement employee and the cost of whoever is doing the training. If a position requires security clearances or other special qualifications, costs of obtaining the clearances or acquiring whatever additional certifications are needed must be recognized.

Pay and Benefits. While a reservist is on active duty, his employer need not pay the reservist's normal pay and benefits, except as noted above. But depending on the source of replacement personnel, companies may incur costs in excess of the pay and benefits of the activated reservists. For example, temporary personnel hired through employment agencies may cost more than permanent staff in equivalent positions, and agencies may charge continuing fees as a percentage of salary in lieu of a one-time commission. (Of course, if replacement personnel are less qualified or have less experience than the reservists they replace, an employer's cost might decline, but at the expense of performance, as discussed in the next paragraph.)

Productivity. If reservists are not replaced, their loss presumably will affect a company's productivity. Even if replacements are hired, productivity may fall, at least temporarily, because the replacement is not a perfect substitute for the reservist. For example, a reservist employee may have a continuing relationship with clients or customers that cannot readily be assumed by a replacement or, indeed, by anyone else in the company. Productivity might also be affected if the temporary loss of a reservist imposes additional workload on other employees, either because the others do not have the special skills of the reservist, because the additional workload affects productivity in

all tasks, or because employee morale declines as a result of the additional demands placed on remaining personnel.

C. LONG-RUN EFFECTS

Activation of key employees may affect a company's overall ability to compete in the marketplace long after the reservists have returned to civilian employment. For some companies, the loss of reservist personnel may mean that clients take their business elsewhere, either permanently or at least for an extended period following the reservist's return. Effects on the morale and productivity of non-reservists can have long-run consequences. And in the worst case, a company's profitability and survival can be affected.

The long-run effects of activating reservists may be much more severe for small businesses, where the loss of an employee constitutes a greater share of the firm's output. The problem of a solvency crisis precipitated by the military activation of a key employee is most likely to arise in small businesses, especially since many of them are sole proprietorships. Another consideration is the size of the local labor market: employers in rural areas or small towns may not be able to find replacement personnel. Long-run costs may also be higher for firms whose employees have special skills or credentials that are not readily available among replacements.

The long-run effects of Reserve activation will also depend greatly on the firm-specific human capital of the deployed reservist. An outsider cannot easily replace a long-serving employee with a deep knowledge of the firm's operations. A sales executive with an extensive network of personal contacts and relationships with customers cannot be replaced by a newcomer without some decline in sales.

Finally, long-run costs are also likely to increase more than proportionally with the number of employees activated. If a single reservist is activated and no replacement is found, then that employee's workload can be spread among other employees. But as more employees are called up and not replaced, the burden on the remaining staff may become unmanageable. Long-run effects may also increase faster than proportionally with the length of a reservist's deployment, especially for small businesses whose risk of bankruptcy increases with the length of absence of an integral employee.

Regaining Lost Business and Productivity. Employers may find that the skills and productivity of their reservist personnel are affected by extended periods of active military service, away from their civilian jobs. Most reservists can be expected to return

to their previous levels of civilian productivity, but their employers might experience protracted periods of reduced output even after the reservists' return. For some companies, the reduction in productivity may translate into lost business; for others, it might mean reduced output or increased demands on other personnel.

Effects on Other Employees. Companies that do not replace activated reservists may find that the remaining personnel experience increased workload. Indeed, such increases may occur even if replacement personnel are hired. Workload increases can impose dollar costs (for example, overtime pay) and non-dollar ones (lower quality, higher accident rate).

Employee Morale. By placing additional burdens on other employees, activation of reservists might affect the long-run stability and morale of a company's workforce. These effects might appear in the form of higher employee turnover or lower productivity, either of which could threaten a company's survival.

D. THE DIFFERENTIAL VALUE OF RESERVISTS

Some companies find that despite the possibility of their being called to active duty, reservists are a desirable pool of potential employees. Among the positive factors associated with Reserve service are employees' experience with military discipline, the value of training received in the military, possession of character traits useful for both military service and civilian employment, and commitment to family, community, and country.

Whatever differential benefits are associated with employing reservists clearly constitute offsets to the various costs that companies incur during the activation of their reservist personnel. It is important to obtain employers' valuation of these benefits, because failure to include them in the calculation would overstate the likelihood that employers will seek ways to avoid the costs that they bear when they employ reservists. Measurement should also include an effort to assess personal and intangible factors valued by employers, as well as financial ones.

III. CONFIRMING THE TYPES OF COSTS

The foregoing discussion of employer costs stemming from the activation of their reservist employees was based on an analysis of provisions in law (USERRA), an awareness of other data on costs of absenteeism and illness, and an understanding of the economics of the firm and production. Policy approaches, however, cannot be based solely on theory and abstract analysis. Confirmation is needed that the employers who actually suffer the loss of their reservists to active duty do indeed experience these (or other) kinds of losses. And an effort must be undertaken to measure the magnitude of those costs, as a first step in designing policy options to offset them.

A. THE SBA SAMPLE

Some information about the actual experience of employers of activated reservists is available from a program operated by the Small Business Administration. SBA offers loans to small businesses that suffer from many different types of unexpected economic reverses. Among the better-known programs are loans to cover losses from earthquakes, floods, hurricanes, fires, and other natural disasters.

A similar SBA program is its Military Reservist Economic Impact Disaster Loans (MREIDLs). For companies that meet certain eligibility criteria, these loans help them offset the economic consequences of the loss of their reservist personnel. To qualify, a company must be able to show that the activated reservist is “critical” to the success of the company. The extent of losses must be documented with financial data, and the company must provide certain supporting information.

The MREIDL program began in 2000, and between its inception and March 2003 (the date of our inquiry) approximately 260 companies had applied for loans. Of those applications, just over 90 were approved, often for loan amounts smaller than what the applicants had requested. Because the applications contain detailed financial information that companies understandably consider proprietary, SBA treats the applications as confidential.

The existence of the program and the identities of the applicants, however, are matters of public record. Accordingly, SBA willingly complied with our Freedom of Information Act request for the names and locations of those companies that had been

approved for MREIDL loans. We drew a sample of the 93 companies thus identified as the basis for a series of telephone interviews with employers actually affected by the activation of their reservist personnel.

For several reasons, our SBA sample should not be considered representative or typical of the experience of companies that have experienced reservist activation. First, the SBA sample consists of small businesses, and while the precise definition of “small” may vary across industries, certainly companies eligible for MREIDLs are not a cross section of American employers. Second, the SBA sample necessarily omits employers in the public and non-profit sectors. Third, companies receiving MREIDLs must lose “critical” employees; thus, they are likely to experience greater losses than other firms. Fourth, successful applicants for MREIDLs may well have different experience from companies whose applications are unsuccessful as well as from employers at large. Fifth, the act of applying for an MREIDL identifies a company as a member of a class that excludes non-applicants and thus introduces a difference between applicants (and recipients) and other companies.

For all these reasons, the extent of economic losses suffered by MREIDL recipients would not be a valid basis for extrapolating the costs of reservist activation or for designing offsetting policies. But the experience of MREIDL recipients might indicate that these companies do suffer the kinds of losses discussed above. And if these employers suffered other types of losses, their experience would suggest broadening this investigation. Thus, the SBA sample offers an initial check on the consequences of Reserve activation.

B. INTERVIEWING THE SBA SAMPLE

To comply with Federal limitations on surveys, the project team conducted telephone interviews with eight of the companies identified as MREIDL recipients by SBA. Interviews were relatively unstructured. Rather than asking a series of specific questions, we attempted to initiate a conversation about how the recipient had been affected by Reserve activation. Without exception, all of the employers contacted were extremely open about their experience. Many provided estimates of their dollar losses and described how they had tried to adapt to the loss of their reservist employees.

The eight companies interviewed were chosen more or less at random from the list of MREIDL recipients. As it happened, they ranged in location from Virginia to Oregon, and from New York to Tennessee. They were predominantly in service industries including automobile repair, building, computer support, and medical care.

The reservists activated included white-collar medical personnel and computer repair specialists as well as blue-collar carpenters and mechanics. A summary of the results of the telephone surveys is presented in Appendix A at the end of this report.

C. FINDINGS AND LESSONS LEARNED FROM THE INTERVIEWS

Lost Business. The most common thread among the interviews was that the primary consequence of a reservist being activated was lost business for his employer. This was true whether the reservist was the owner, sole employee, or key employee. Marginal companies (those with few employees other than the reservist/owner) tended to shut down from inability to perform on existing contracts or obtain new ones. But even companies that were able to continue suffered a loss of business that could put the future of the company in jeopardy.

Replacing the Reservist. One characteristic of the SBA loan recipients is that their reservists are key personnel; indeed, that is a requirement of the loan. In many cases the Reservist was so important that it was not possible or feasible to replace him. In others, the replacement was only partially effective. When the reservist was replaced, the company incurred additional costs associated with its search, hiring, and training. But even companies that were able to replace the reservist experienced a loss of business from the activation.

USERRA Provisions. USERRA is not an issue for many small businesses because frequently the activated reservist is the owner of the company. Some of the companies in the sample opted to go beyond USERRA in terms of providing health insurance and/or replacement of some or all of the reservist's lost income during his period of service. None of the interviewees mentioned any difficulties or conflicts over USERRA provisions. There was a general recognition of the needs of the military and the importance of service in the Guard and Reserve.

Return of the Reservist. A consistent finding among companies that have had time to adjust to the return of their reservist employees was that there is a substantial phase-in period. It frequently took more than 6 months, and perhaps more than a year, before the company was able to reestablish the level of business that it enjoyed before the reservist's departure. Even companies whose reservist had not yet returned anticipated a significant lag in the return of business to previous levels.

Long-Run Adjustment. Even if a company survives the activation of a reservist, it may not be able simply to return to its previous status once the reservist returns. A

company that replaces its reservist may be locked into retaining the replacement, even if that results in a permanent increase in cost. The reservist may not be able to resume his previous position because during his absence the company was forced to develop a new work structure. Or the company may have decreased its reliance on the reservist to guard against future activations.

Availability of Data. All of the companies interviewed had to provide SBA with extensive documentation of their projected losses from activation. Although in some cases the estimates proved to be incorrect, in others there was information on several categories of costs, and still others indicated that detailed information could be found although the interviewee did not have it. Companies interviewed well after the return of the reservist were able to estimate the loss of business during the phase-in period as well as during the period of active duty.

Willingness to Respond. All of the individuals interviewed were extremely forthcoming about their companies' experiences. No one contacted refused to respond, or indeed exhibited any reticence about discussing their company's problems. It is likely that some of the interviewees hoped that they would receive relief of some kind as a result of the interview, although it was made clear that the interview was in connection with a project for the Department of Defense, not SBA, and that the work for DoD was in its early stages. All the respondents were cordial and free with their time. It was actually pleasant to speak with them, although somewhat frustrating because of the interviewer's inability to offer any kind of direct help. Some of the companies had previously been interviewed by the media and were well-prepared to respond.

Severity of Harm. It must be noted that for many small businesses, loss of a key employee to active duty is virtually a catastrophic event. This is true whether the employee is a skilled professional or an experienced blue-collar worker. Of the eight companies interviewed, four experienced losses so great that they either closed the business or cast doubt on its future, and another barely survived during the reservist's activation. It seems likely that the experience of small businesses will differ in this respect from that of larger companies, since many small businesses (including several in this sample) are heavily dependent on the skills, market contacts, or personal qualifications of a single individual.

D. NCESGR FEEDBACK

On the basis of the conceptual discussion of employer costs (Section II, above) and the results of the interview of the SBA sample, the project team prepared a draft

questionnaire covering the various effects that might be expected from Reserve activation. The questionnaire addressed all of the financial consequences of activation, including both mandated and voluntary benefits, replacement costs, and lost business. It also asked about longer-run effects, such as the lag between a reservist's return from active duty and the employer's full recovery from the losses or costs due to activation.

The project team then solicited reactions and comments on the draft questionnaire from attendees at the 2003 Annual Meeting of the National Committee for Employer Support of the Guard and Reserve (NCESGR). The attendees, most of whom were either state chairmen or executive directors of the state committees, constituted a group familiar both with Guard and Reserve programs and the needs and concerns of employers. Indeed, one of the functions of the state committees is to operate call-in centers where employers may seek information about their rights and obligations concerning reservist activation, and where reservists may obtain information or discuss problems related to their individual situations.

The material presented to the NCESGR was not a survey instrument, and the attendees were not asked to obtain data about the costs and other effects that employers experienced during Reserve activation. Instead, attendees were asked to judge whether the categories of costs covered in the draft questionnaire were comprehensive, in the sense that all of the consequences of activation were included. In addition, attendees were asked to solicit comments about coverage in the questionnaire from individual employers in their states, with an emphasis on medium or large employers (defined, arbitrarily and somewhat loosely, as those with more than 25 employees).

The project team received a number of responses from attendees, individual state "ombudsmen" to whom the draft questionnaire was referred,¹ and staff from the national headquarters of the NCESGR. Comments varied from a critique of the layout of the questionnaire to concerns about its apparent bias toward the costs imposed on large companies. Several respondents affirmed that the coverage of the draft questionnaire was consistent with their experience. Some noted that smaller companies are not likely to incur many of the types of costs covered in the questionnaire, such as benefits mandated under USERRA (a point discussed in the preceding section of this report). None of the respondents suggested new categories of costs, but some urged that attention be given to the positive aspects of employing reservists (see Section II.D, above).

¹ State ombudsmen staff the call-in centers and respond to calls from Reservists and employers. They accordingly have wide familiarity with the types of problems that stem from Reserve activation.

E. DRAFTING A SURVEY INSTRUMENT

Using the information from all of the aforementioned sources, the project team drafted an instrument that could provide the basis for the preparation of a questionnaire to be administered to employers. The draft instrument included sections where employers could be asked about all of the types of effects discussed above in Section II, and also addressed the issues of long-run effects and recovery lags that arose in some of the interviews with the SBA sample. The goal was to develop an instrument that is as comprehensive as possible, to allow employers to address all of the consequences that stem from Reserve activation.

The project team recognized that no instrument can be appropriate for all types of employers. Small businesses are likely to face a different set of concerns from those that apply to larger employers. Employers in the public and nonprofit sectors may not have the same problems as for-profit companies. It is important that employers have an opportunity to provide open-ended responses, to describe situations that cannot neatly be summarized in dollar terms.

These considerations led to the preparation of the project team's draft survey instrument, which appears in Appendix B at the end of this report. It is important to realize that the team does not offer this document as a survey-ready instrument, since the team does not possess expertise in survey research. Rather, it is a guide to the potential preparation of an actual survey instrument by a trained survey researcher. The team offers the draft to indicate the coverage needed in an actual survey instrument, and to illustrate the kinds of information that might be obtained to guide the preparation of policy options.

IV. OTHER DATA ON EMPLOYER COSTS

A survey instrument to assess employer costs from activation of their reservists would not be needed if other data were available. The project team examined data from other sources both to obtain a preliminary estimate of employer costs and to judge the need for a survey or other data-gathering effort. Data on reservists were available only in the 2000 Survey of Reserve Component Personnel conducted by the Department of Defense.¹ In some cases, however, we were able to adjust data from other sources for the characteristics of reservists. We also examined data on employer family and medical leave policies, which shed some light on the extent of pay continuation during employee leaves and the prevalence of replacement costs. A full description of IDA's findings is presented in Appendix C, including the various sources employed and the details of each calculation. The rest of this section summarizes those findings.

A. EMPLOYERS OFFERING HEALTH BENEFITS

About three-quarters of all U.S. workers are offered health insurance coverage by their employers, but not all choose to accept it. In 2001, about 63 percent of all employees were covered by their employers' health insurance plans. The availability of coverage varied by size of company: only 55 percent of very small employers (3–9 employees) offered a plan, while 96 percent of those with 200 or more employees did so. Within the private sector, over 60 percent of all employees participated in health plans. Personnel in professional, technical, and related occupations were somewhat more likely to participate than those in clerical/sales or blue collar/service occupations.

Data from the survey of Guard and Reserve personnel suggest that reservists are more likely than the population as a whole to be employed in small firms. If reservists have the same patterns of coverage as other employees in their firms, only about 56 percent of reservists in private-sector employment participate in health care plans through their employers. Adding public-sector employment to the calculation brings the overall fraction of reservists covered by their employers' health care plans to 65 percent.

¹ *2000 Survey of Reserve Component Personnel* [CD-ROM] 2002, Arlington, VA: Defense Manpower Data Center [Producer and Distributor].

B. EMPLOYERS OFFERING PENSION BENEFITS

A similar calculation can be made for pension plans. USERRA requires that when a reservist returns from active duty, his or her employer must make any contributions to the reservist's pension plan that would have been made had the reservist been employed during the period of military service. In 2001, just over 60 percent of all workers aged 21 to 64 worked for employers who offered retirement plans, and just under half of all workers elected to participate in those plans. As with health benefits, the percentages of employers offering plans and employees participating was high among public-sector and large private-sector employers, and much lower for the smallest private-sector companies.

If reservists were typical of the entire worker population, then these patterns of pension plan availability and participation would suggest that about 58 percent of all reservists have employer-sponsored retirement coverage. In fact, reservists are atypical in that they are younger, on average, than the larger work force, and younger workers are less likely to elect to participate in retirement plans. Adjusting for the difference between the age distribution of reservists and that of the overall work force yields an estimate that only about 50 percent of all reservists participate in employer-sponsored retirement plans.

C. COST OF BENEFITS

Data on the cost of employer-provided benefits generally are expressed as costs per hour, or sometimes as a fraction of the cost of direct wages and salaries. The problem with these data is that they include hours worked (or direct compensation) for employees who do not participate in employer-sponsored plans, and thus understate the cost per covered employee. In addition, the data sometimes need adjustment to reflect both the difference between full-time and part-time workers, and the dollar amount of employees' contributions.

The project team made these adjustments to estimate the costs of retirement plans to employers. For private sector employers that offer retirement plans, the cost per participating employee for 1 month's payment into the retirement plan averages between about \$250 and \$370. The corresponding figure for public-sector workers is about \$425. Averaging these costs across reservists, weighting by the distribution of reservists among different categories of employers, results in an estimate of about \$375 in retirement plan costs per month, per reservist.

For most employers, the costs of providing health care coverage to activated reservists is less significant than the cost of retirement plans, since USERRA mandates

the continuation of health benefits only for activated service of less than 30 days. The employer's share of the average cost of health care coverage varies from about \$215 (for employee-only coverage) to about \$500 (for families of different sizes). The data did not permit adjustments for employer size or participation rate.

D. OTHER EFFECTS OF RESERVE ACTIVATION

In addition to paying for reservists' benefits, employers of activated reservists might experience a range of other consequences including changes in workload and productivity for remaining employees, replacement of activated reservists, and long-run effects on overall business volume and profitability. Data that shed light on these other effects, including some non-monetary costs suffered by employers, are available from a survey conducted by the Department of Labor (DoL) of employers affected by the Family and Medical Leave Act (FMLA) of 1993. This act requires covered establishments to provide up to 12 weeks of job-protected, unpaid medical leave per year to enable employees to care for a new child or sick family member.

Most employers surveyed said that FMLA had no effect on their business's performance, but substantial minorities (up to 25 percent) reported negative effects on business productivity, profitability, and growth. Smaller firms (those with 250 or fewer employees) seemed less likely to be affected by FMLA than larger ones, but they tended to report more negative effects on growth. Overall, these results are broadly consistent with the findings from the project team's SBA interviews, which found that the absence of a key employee often had severe consequences for overall business performance.

The DOL survey also asked employers about changes in costs since the inception of FMLA. A slight majority of employers reported an increase in administrative costs, and about one-third of all employers reported that their hiring and training costs had risen. Almost all employers had reassigned work to other employees, raising the possibility of avoiding replacement costs at the price of affecting employee morale. A large minority of firms hired a temporary replacement, and large firms were more likely than smaller ones to do so. Indeed, about 45 percent of establishments covered by FMLA reported hiring either a temporary replacement or a permanent one when their employees took FMLA leave, notwithstanding the job-guarantee provisions of FMLA. Employers also commonly deferred some work or asked the employee on leave to do some work during the period of leave.

Curiously, covered establishments appeared more likely than non-covered ones to hire replacement personnel during employees' leave (45 percent vs. 40 percent). This

anomaly, and other selected findings of the survey, might stem from the differences in business practices between larger firms and smaller ones, which are less likely to be covered by FMLA. One such business practice is the continuation of pay during employees' leave. Small, non-covered businesses are more likely to continue paying their employees during leave than are small, covered businesses, perhaps because the non-covered businesses (with 25–49 employees) tend to have closer relationships with their employees than the covered establishments (with 50–99 employees).

E. SUMMARY

The data discussed in this section do not provide a definitive answer to the question of what costs employers experience during Reserve activation, but they generally support the cost categories included in the project team's questionnaire, and they offer some guidance as to the level of costs to expect employers to report. If the employers of activated reservists are typical of employers at large, USERRA might be expected to mandate pension and health care costs of the order of \$300–\$400 per month, per benefit, per reservist. An employer providing the minimum benefit mandated by USERRA will spend far more on pension contributions (which must be continued indefinitely) than on the continuation of health benefits (which must be continued for only 1 month).

In addition to USERRA-mandated benefits, many employers will incur costs related to replacing activated reservists. Survey results show that many employers react to their employees' extended leave by hiring and training replacements, but replacement personnel often are not able to prevent the establishment from experiencing losses in business performance, profitability, and growth. Moreover, many employers elect to go beyond their legal responsibilities in terms of paying at least partial salaries to employees on extended leave. Although such voluntary payments are not, strictly speaking, costs that can be ascribed to a legal mandate, employers may view such payments as the price of maintaining long-run worker morale, and if so such payments are a cost of Reserve activation that should be included in any further study of this issue.

V. OPTIONS FOR OFFSETTING EMPLOYER COSTS

A. REASONS TO OFFSET COSTS

There are two main reasons to consider offsetting the costs incurred by employers when reservists are called to active duty. First, those costs might lead employers to change their behavior towards employees who are reservists. For example, employers might choose not to hire applicants who are reservists, they might terminate reservist employees at a higher rate than other employees, or they might discourage their reservist employees from volunteering and reenlisting, possibly using implicit threats of dismissal or denial of promotion. Any of these actions would be illegal under USERRA, but that alone does not rule out the possibility of their occurrence.

Affecting Employers' Behavior. Some employers might be willing to risk any of the illegal actions to reduce the costs stemming from Reserve deployments. Even if there is little evidence of such employer behavior at present, the risk exists that an increase in the frequency of deployments would raise employers' present costs as well as the future costs that they expect from employing reservists, leading to the kinds of actions described above. Payments to the employers of reservists to offset the costs of current deployments would tend to reduce the expected future costs from deployment, negating some or all of the adverse effects on reservist employment.

Even if offsetting payments affect employer behavior in ways helpful to reservists, the payments may not be cost-effective if they are offered to all employers of reservists. Employers who do not discriminate against their reservist employees will receive benefits, as well as those who do. The cost-effectiveness of these policies therefore depends on whether there exist a substantial number of employers whose behavior is being affected by increased Reserve call-ups, and whether that behavior could be changed by the kinds of approaches discussed below.

Fairness Among Employers. The second reason to offset employer costs is the consideration of fairness. At present, employers are forced to bear some of the costs of Reserve deployment, and the burden is not shared equally among employers. Only employers who employ reservists are asked to shoulder the costs of their deployment, leaving all other employers with no corresponding cost. Among those who do employ reservists, costs can vary widely: some employers will face little or no impact, while

others face potential bankruptcy. Offsetting payments to employers could reduce the inequality of this legally mandated burden upon employers.

Intersectoral Issues. The objective of influencing employer treatment of reservist employees would seem to apply mainly to for-profit companies since it assumes that employer behavior is dictated by profit maximization. The strong tradition and policies of non-discrimination among public sector employers also make it less likely that offsets would be needed to ensure equal treatment of reservists by these employers. This might suggest that offsetting payments should be aimed only at private-sector employers, although it leaves open the question of whether public policy should also be aimed at private employers in the not-for-profit sector of the economy.

However, offsetting payments could affect public and private non-profit employers who are motivated to minimize costs for budgetary reasons. Public sector managers may be less favorable to employing reservists if they are concerned that the costs of replacing activated reservists could lead to budgetary problems or reductions in service that would reflect poorly on agency performance. Offsetting payments could alleviate these budgetary problems, permitting the payment of overtime or hiring temporary replacement personnel to maintain levels of service.

The fairness consideration applies equally to all types of employers. Indeed, certain public sector and private nonprofit employers may be among those most affected by Reserve call-ups. For example, police departments may be disproportionately affected by call-ups of Reserve military police, hospitals by call-ups of nurses and doctors. A strong case could be made on fairness grounds for extending offsets to all employers of reservists.

B. REIMBURSING FOR MANDATED BENEFITS

The Department of Defense could attempt to offset the health insurance and pension payments that employers make on behalf of reservists on active duty. The simplest method would be to reimburse employers for their actual pension and health insurance costs. Employers would submit claims for reimbursement along with proof of payment of pension contributions and health insurance premiums. The Department would verify these claims and remit payment to the employers.

This approach would be feasible because the payments being reimbursed are fully verifiable. The policy could easily be justified as fair because employers would be reimbursed for their actual costs, and all employers would be treated in the same way.

However, mandated benefits are more likely to be paid by large employers, and thus may constitute a larger portion of activation costs for large employers than for smaller ones. If so, this policy could be perceived as unfair to small employers.

Direct reimbursement is also likely to be the most effective way to affect employer behavior, because employers' true costs are reimbursed, removing a motivation for differential treatment of reservists. Nonetheless, the costs of the reimbursement strategy would be high. Processing claims for reimbursement would require a dedicated staff in the federal government. Employers would also incur the costs of submitting claims, and of delays in payment due to processing.

To reduce these costs, an alternative approach would be for the Department of Defense to compensate employers for health and pension benefits at a fixed rate per day of active service. This would minimize administrative costs for both employers and the federal government, and might well result in faster reimbursement. In fact, such a policy could be implemented without the need for employers to file any claims as long as the Department had a record of reservists' employers, to whom payment could be sent. The amount of the reimbursement per active duty day could be based on national averages for health insurance premiums and pension contributions.

Such administrative simplicity would come, however, at the cost of policy effectiveness. A fixed payment would be fair in the sense that all employers would be treated equally, but it would be open to the criticism that employers with higher costs did not receive higher benefits. And as long as employers had unreimbursed costs, they would have some incentive to discriminate against reservists, to the detriment of Reserve component recruiting and retention. Still, this approach has a plus side in that small companies that tend not to pay fixed health and retirement benefits would nonetheless be entitled to some reimbursement for the loss of their reservists.

A third method would be to reimburse employers for mandated benefits based on the characteristics of the employer and reservist. This system would be similar to the fixed payment system but would specify more than one payment amount based on such characteristics as the location and industry of the employer, and the occupation of the reservist. The fixed payments could be based on national averages for health and pension benefits for the given characteristics, as compiled by the Bureau of Labor Statistics (BLS).

Under this approach, employers would have to file a simple form listing their relevant characteristics and those of their reservist employees. Federal personnel administering the program would then assign benefits based on employers' filings and a BLS-based table of reimbursements, which could be revised annually with updated BLS data. Administrative costs for both employers and the federal government would probably be considerably lower than under the first approach—reimbursing actual costs.

Compared with a fixed reimbursement based on national averages, the tabular approach would offer several advantages. For most employers reimbursements would be closer to their costs, so the reimbursements would be more likely to offset actual costs and thus avert employment practices adverse to reservists. But whether the reimbursements actually mirror employers' costs depends on the extent of variation in benefit payment among employers in similar regions and industries with similar work forces. If benefits vary widely within these categories, then the table of payments might be only little more effective than the fixed payment. Empirical data on employer costs is required to resolve this issue. The tabular approach also could be criticized as inequitable for providing different reimbursements based on industry, region, or occupation.

A different approach to offsetting mandated benefits would be for the Department to make payments directly to reservists, to allow them to purchase private sector health insurance for their families during periods of activation. (Reservists' own health care while on active duty is provided by the military services' health care system.) That approach would remove the obligation for employers to provide for their employees' health insurance. The effectiveness of this strategy is limited by the fact that it does not address employers' pension mandates, only their 30-day health insurance requirement. A system of fixed payments to reservists would not impose high administrative cost on the federal government, and of course employers would bear no cost.

At present, reservists called to active duty are enrolled under Tricare, the military's health care coverage system, which includes coverage for family members while the reservist is on active duty.¹ Although Tricare mandates deductibles and co-payments, its cost to reservists is likely to be considerably below that of private health insurance, and in many cases below the reservists' share of costs under employers' plans.

¹ Initiatives have been offered in Congress to extend Tricare to all drilling reservists, whether or not they are on active duty. Passage of such legislation obviously would make this discussion moot.

For most reservists, accordingly, the provision of health care coverage during their active service is unlikely to be a major factor in their decision about whether to remain in service.

C. OFFSETTING REPLACEMENT COSTS

The Department of Defense could attempt to offset the replacement costs that employers incur from Reserve activations. As with mandated benefits, the potential approaches include reimbursing actual costs, compensating at a fixed rate, and compensating according to employer characteristics. A strategy of reimbursing actual costs would require employers to submit claims for such replacement costs as their search expenses (for example, advertising and employment agency fees), training expenses for replacement workers, and the additional cost of a temporary worker over the wage of the reservist. These claims would be evaluated and the associated costs reimbursed to the employer for claims determined to be valid.

Although offsetting employers' actual costs would potentially be the most effective technique, that approach might not be feasible. Claims would be difficult to verify, and the evaluation of claims might require a substantial bureaucratic effort. Administrative costs would be high. The effectiveness of such an approach could also be damaged by moral hazard on the part of employers. Employers might, for example, spend more on training and employment agencies if they believed that their expenses would be reimbursed. Thus the act of reimbursement might increase the costs to be reimbursed. The fairness of the process of judging the validity of claims might also be open to challenge.

Compensating employers at a fixed rate for replacement costs is a feasible, low-cost alternative to reimbursing actual costs. An average replacement cost could be estimated from a survey of Reserve employers to provide the basis of a fixed, periodic payment to employers while an employee was in active service. The fairness of this approach could be justified on the basis that all employers would be treated equally, receiving equal payments. The payments to any individual employer, however, might not bear any relation to the employer's actual cost. Thus, a fixed payment would confer windfall gains (on employers with low or no replacement costs) and losses (on those with high costs).

Moreover, the effectiveness of fixed payments would be questionable. Employers with high replacement costs who deemed the payment inadequate might simply disregard it in considering how to treat reservist employees. Based on the earlier discussion in

Section II about the likely relation between replacement costs and length of deployment, fixed periodic payments would tend to overpay employers for very short or very long deployments and underpay for call-ups of average length.

An intermediate approach would be to compensate employers based on employer and reservist characteristics. A survey of employers could yield data on actual replacement costs incurred by employers of different sizes, and in different industries and locations, to replace reservists in various occupations and at different levels of experience who were called to active duty for different lengths of time. Average replacement costs for employers in each category could then be arrayed into a table. Such an approach would be technically feasible as long as the survey of employers yielded enough data to calculate reliable average costs for each category. Administrative costs of this approach would be low compared with reimbursing individual employers' actual costs.

If payments varied by firm size, they could implicitly recognize the economies of scale that larger firms may enjoy in search and training, and could compensate smaller employers at a higher rate. Payments could vary by employer location in order to allow for differences in replacement costs in different labor markets; for example, between rural and urban markets. Basing payments on the length of the call-up would allow the payments to take account of any rise and decline of replacement costs over the duration of active service. The payment might also depend on the occupation and experience of the reservist, to recognize that search, hiring, and other replacement costs are not uniform among various categories of employees.

Using a table of payments should be more effective than a uniform, fixed payment to all firms. With a table, payments would tend to be closer to actual costs and thus would be more likely to affect employers' behavior to preclude discrimination against reservists. The key question is whether costs are fairly similar for similar categories of employers and reservists but are more variable based on such characteristics as firm size, industry, location, and reservist occupation and experience. That question can only be answered by examination of the data that would result from a comprehensive survey of employers to ascertain the costs that they incur from Reserve activations. Certainly a tabular approach would be administratively less costly than reimbursing actual costs. Although that approach would not treat different categories of employers equally, any issue of fairness should recognize that many federal programs apply differently to different types of employers. In addition, the table of benefits could be defended as being based on employers' actual costs.

D. COMPENSATING FOR LOST PRODUCTIVITY AND BUSINESS

Whether they replace activated reservists or not, employers may experience losses of business and productivity during the reservists' absence and even after their return. Such losses may be extremely difficult to offset, for several reasons. First, they are likely to vary among firms, based on a reservist's specific position within a firm and the company's own market position. Second, losses may be difficult to quantify, since the absence of a reservist may not be the only factor affecting a firm's output or income during the period of the reservist's active service. Third, verifying or auditing a firm's claims about the extent of losses would be expensive and time-consuming.

Nonetheless, a policy that offset firms' losses in productivity and revenue might be extremely important in counteracting employers' adverse reactions to reserve activations. Particular for small firms, as indicated by the SBA sample interviews discussed above, the loss of a reservist may threaten the viability of a company and almost always leads to severe losses both during and after the period of active service. Thus, it is important to consider the possibilities for offsetting these consequences.

Unfortunately, policy options in this case are limited. Potential approaches include reimbursing actual costs, compensating at a fixed rate, compensating according to employer characteristics, and a loan or loan guaranty program. Any of these approaches would have to be based on data from employers, such as lost sales or production, that would have to be independently validated as stemming from the loss of the reservist to active service. Employers would have a strong incentive to overestimate their claims of loss in order to receive higher payments. Thus, development of a reliable data base on losses in business or productivity is likely to be administratively costly, requiring an extensive audit of data obtained from surveys of employers.

Once the effort to develop a data base has been made, the Department might then compensate employers for lost business and productivity at a fixed rate based on the average losses in the data base. Such a policy would have low additional administrative costs, but it might well be ineffective. A fixed payment would compensate many employers for costs they had not incurred, while under compensating those employers that did incur the cost. The fixed payment would also fail to take into account both the greater burden these costs place on small businesses and the extra burdens on those employers where many employees are called up.

An alternative approach would be to compensate employers for their actual losses. Such a policy would not incur additional administrative costs initially, but it would

require expensive audits to verify costs for every year after the initial data collection and verification. It would also burden employers with data submissions and applications for reimbursement on a continuing basis. Although such a policy would be effective and fair, its high administrative costs could be prohibitive.

A third approach, as with other costs, is to relate reimbursements to employer and reservist characteristics. This approach would not impose high administrative costs after the initial data collection and verification. It offers the advantage of being able to develop a different compensation approach for small firms, which may be most at risk from Reserve call-ups. It could even include compensation that increased faster than the duration of active service, to reflect the increasing risk from longer-term absences. Other factors that could be taken into account include employer and reservist characteristics, such as the reservist's experience level or the number of reservists activated.

Such an approach would be more effective than fixed payments if the factors taken into account brought an individual employer's reimbursement more closely into line with actual costs. In fact, the SBA sample interviews suggest that costs are likely to vary widely among firms, so any adjustment that relates costs to individual firms' circumstances should improve program effectiveness. Nonetheless, the kinds of characteristics that can be used to adjust reimbursements are not likely to be closely related to lost business and productivity. For one thing, employers with similar characteristics may have greatly different abilities to replace their lost reservists. For another, factors such as market share, overall company stability, and internal organizational structure may be more important in determining lost business and productivity than characteristics that are easier to measure. These considerations call in question both the effectiveness and the fairness of a variable-payments tabular approach.

A fourth approach, different from those discussed for other categories of costs, would be for the federal government to offer compensation or reimbursement to those employers whose long-run viability is most threatened by Reserve call-ups. Such a program might be modeled after the SBA MREIDL program, which offers "disaster loans" to companies that lose key personnel and can document the consequences. It is not necessary that a broader program apply only to small businesses, or that it offer loans or loan guarantees; rather, the key is that companies at risk for substantial long-run losses not covered by other offsets would have some recourse.

Any such program would differ greatly from the kinds of offsets and reimbursements discussed above. It would apply only to a limited number of employers,

namely, those who could demonstrate losses at a level that threatened the company's long-run survival and that were not offset by other programs. It would require case-by-case administrative determinations of eligibility and the extent of reimbursement, and thus would have high administrative costs per recipient. It would be fair only in the sense that all equally affected companies had an equal opportunity to receive reimbursement, and it would be effective only for those employers who received benefits related to their long-run losses. Nonetheless, a program modeled after catastrophic-loss indemnification may provide the best approach to dealing with long-run losses of business or productivity resulting from Reserve activation.

E. TAX CREDITS VS. DIRECT REIMBURSEMENTS

In the public policy arena, tax policy is a popular alternative to direct expenditures for reasons that are unrelated to program effectiveness. Tax policy—for example, tax credits for certain types of behavior—is inexpensive to administer and does not require, or permit, federal authorities to exercise discretion over its availability. Tax credits can be defended as tax cuts, in contrast to direct expenditures, which require increases in revenue or cuts in other programs to pay for them. And tax credits do not increase the overall federal budget (although if they are not accompanied by offsetting expenditure cuts, they do increase the deficit). For reasons such as these, tax credits should be evaluated as an approach to reducing or offsetting employer costs.

The merits of using tax credits to offset employer costs must be evaluated with respect to all employers who are affected by Reserve activations. Much of the preceding discussion has implicitly referred to the behavior of employers in the for-profit sector of the economy, who are most likely to be affected by considerations of profitability and whose long-run viability is most likely to be at risk in the event of Reserve activations. It is widely understood, however, that for-profit employers are not the only ones affected by the loss of reservists; thus, USERRA applies to all employers, including governmental agencies. As discussed above, public and not-for-profit employers as well as profit-making firms may be affected by the loss of reservists in ways that call in question their support for reservist employees. Efficiency as well as fairness thus suggests that cost offsets or reimbursements apply equally to all employers.

Unfortunately, tax credits have several disadvantages as a vehicle for offsetting employer costs. First, of course, is that tax credits would affect only employers in the for-profit sector of the economy, although there is anecdotal evidence that some of the most severely affected employers are public agencies such as police and fire departments.

Second, tax credits would be of value only to those for-profit employers who had large enough tax liabilities to take advantage of them.² Some of the employers who are most affected by the loss of reservists, and whose long-run survival is most at risk, would receive less benefit than other employers who incurred smaller costs. Third, there are administrative questions that would have to be addressed, such as documenting the losses that qualified for credits, which might raise the burden on employers and negate some or all of the value of the tax credit.

If, despite these considerations, tax credits were employed instead of direct reimbursements to offset costs, much of the burden for administering the program would lie with the Internal Revenue Service rather than the Department of Defense. Inasmuch as the primary objective of any cost offset would be to encourage employers to be supportive of their reservist employees, it would be desirable for the Department of Defense to administer the program to ensure consistency with its underlying purpose. In contrast, leaving administration to any other agency might result in dilution of program effectiveness or substitution of other agency goals. For example, the IRS might focus on overall cost reduction for program administration, rather than targeting tax credits to the most severely affected employers. In addition, control of the program by the Department of Defense would facilitate merging data from different sources to improve effectiveness and fairness.

F. RELAXING USERRA MANDATES

An entirely different approach to reducing the costs that employers incur from the activation of their reservist employees would be to ease their burdens under USERRA. Such an initiative would be aimed both at lowering the financial costs on employers for continuing health and pension benefits and at easing the impacts on business from not being able to replace reservists without considering their right to return to their previous (or equivalent) positions. The approaches discussed above would impose costs on the federal government in order to offer benefits to employers. Relaxing USERRA requirements, in contrast, would shift some of the costs of activation from employers to reservists, without requiring any expenditure on the part of the federal government.

² In principle, tax credits could include direct payments to employers whose tax liability was less than the amount of the credit. Such a “negative income tax” approach is used for the earned income credit that is an element of the federal individual income tax law. In addition, tax law permits filers to carry net losses forward or backward for several years to offset net income. Multi-year income averaging could be extended to permit more firms to take advantage of tax credits.

USERRA stipulates that employers must provide health and pension benefits to serving reservists, and also obligates employers to guarantee an equivalent job to a reservist following return from activation. Repeal of the benefit provisions would directly eliminate the mandated benefits category of costs. Repeal of the job return guarantee could reduce replacement costs by allowing an employer to replace an activated reservist on a permanent basis. Permanent workers might be less expensive than temporary workers, and training a worker for a permanent job offers a greater return than adjusting to a temporary employee. Repeal of the job guarantee provision could potentially also help employers if temporary workers cannot be found for certain occupations but permanent workers are available. Professional workers may be unwilling to work on a temporary basis.

Repealing any part of USERRA, however, would place major new burdens on reservists. The loss of health coverage and pension contributions would expose reservists and their families to additional financial uncertainty or costs of providing their own coverage. The loss of the guarantee of a job to return to would expose reservists to a significant risk of unemployment following a period of active service. DoD could offer transition grants to reservists who were laid off during activation, but it is unlikely that such grants could fully compensate reservists for the economic impact of job loss. Such adverse effects on reservists would probably harm recruiting and retention to a greater extent than could be offset by gains from employer support.

A further disadvantage of providing relief to employers by repeal of USERRA protection for reservists is that such a policy would provide the most benefit to those employers that least needed cost relief. If the job guarantee provision were removed, employers could be expected to lay off those activated reservist employees who were most easily replaceable. Employees who were integral to the business or impossible to replace would still be offered their jobs back upon their return from active service. Thus, employers with the least to lose from the activation of their reservists would benefit from the repeal, while no relief would accrue to those employers who lost key personnel.

The effects of repeal on reservists would also be unequal. The reservists who would be most likely to lose their jobs would be those who could most easily be replaced, and thus those who are the least skilled and have the least human capital to offer their employers. Those reservists are more likely to be junior, lower-income personnel with the least ability to compete for new jobs. Thus, repealing USERRA's protection is unlikely to be fair to either employers or reservists.

VI. NEXT STEPS

The data we collected on pension and health insurance costs are based on U.S.-wide published data and are not limited to reservists' employers. These data, combined with the information on temporary replacement costs and the long-run effects of Reserve activation on small businesses, are suggestive but not sufficient to support recommendations for mitigating employer costs or not mitigating them. A survey designed to elicit these costs from a representative sample of reservists' employers is needed to assess employer costs from activation of their reservists.

Fielding the employer cost survey is the next step in providing the Department of Defense with information about the costs that mobilizations impose on employers. A survey research firm must review and refine the draft employer questionnaire presented in Appendix B and submit it to the Office of Management and Budget for approval. As soon as OSD's reservist employers database is sufficiently populated, IDA will analyze the employer data and create a policy- and survey-relevant description of the size, industry, and other characteristics of reservists employers. With this in hand, IDA will work with the survey research firm to develop a survey sampling plan.

IDA will analyze the survey results, summarizing the magnitude and variability of costs within the various policy-relevant categories. If warranted by the results, IDA will examine the feasibility and costs of alternative options for offsetting employer costs.

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Appendix A

THE MREIDL INTERVIEWS

Following is a summary of interviews that project staff conducted with representatives of a sample of the 93 companies that have received Military Reservist Economic Impact Disaster Loans. To protect the privacy of the interviewees, we provide only a business description and the role of the person interviewed rather than actual names.

Company: Automotive Service, Portsmouth, VA

Interviewee: Reservist Owner

Discussion: The owner was the activated reservist. He employs primarily mechanics in an auto repair business. His response to being activated was to hire a new employee to take over some of his management responsibilities, and to lay additional production workload on existing staff; in both cases, the result was higher payroll costs. Nonetheless, he lost business during the period of his activation, and in fact has had his business up for sale. He estimated for his loan application that his losses would total \$100,000, but thinks that in fact he did not lose that amount in either lost business or additional costs. As he is the owner of the business, USERRA provisions (retirement contributions, reemployment rights) do not factor into this experience.

Company: Veterinary Hospital, Oakton, NY

Interviewee: Wife of the reservist owner

Discussion. The activated reservist, currently in Afghanistan is also the sole veterinarian as well as owner of the hospital. In anticipation of his being called to active duty, the hospital sought for over a year to find a replacement, but was unable to do so for some 16 months. Eventually a new doctor was brought in, but her salary (\$65,000) is far in excess of what the reservist owner was taking out of the business. The owner's wife estimates that the additional annual costs of pay and benefits are over \$40,000. In addition, the hospital incurred transaction costs of \$4000–\$5000 for advertising for a new doctor and attorney's fees to prepare a contract for her. The higher salary costs could not offset a decline in business that the owner's wife estimates at over \$40,000 for the 8 months that

the hospital had no doctor on staff; and, of course, the loan of \$49,500 from SBA has carrying costs. In the long run—after the owner returns—his wife anticipates that he will no longer be able to practice full-time, because their cash flow requirements will require him to find a salaried job. The new doctor will remain on staff, because to hire her the hospital had to make a long-term commitment, and there is not enough business in prospect to support two veterinarians.

Company: Consultants, Chicago, IL

Interviewee: General Manager

Discussion. The company is owned by two men and their wives; both men were activated, and the general manager (GM) was hired to run the company in their absence. (Its business is in computer hardware and Internet access.) Prior to activation the business was selling about \$100,000–\$110,000 of hardware annually, but those sales declined by 50 percent and the company lost about one-third of its Internet customers, for a total loss that the GM estimates between \$100,000 and \$150,000. The company ran up unpaid debt and was not able to pay the GM more than \$150 per week while the owners were on active duty. The GM says that if the owners were to be called to active service again, now that he is in place he would hire additional employees to provide customer support during their absence. He has been successful in hiring and training interns, and thinks that in that way he could avoid any long-run failure.

Company: General Contractor/Carpenter, Cleveland, OH

Interviewee: Reservist owner and his wife

Discussion. The reservist owner was a general contractor and carpenter whose business volume prior to his activation was about \$400,000. He employed nine workers and had a weekly payroll of \$3,000. When he was activated his wife tried to keep the business running under the supervision of his brother and son, but neither they nor any of the workers had the skill or experience to manage the operation. According to the reservist owner, the workers were not even at journeyman level, and much of his business rested on his clients confidence in him, personally. The wife says that the company was unable to perform on its existing jobs, let alone undertake new ones, and as a result she was forced to lose the business while her husband was deployed (to Qatar). Upon his return, he was so depressed at the loss of the business that he left home and is at present in Texas. He claimed that a number of states—but not Ohio—provide considerable assistance for companies like his, including loans and outright grants well above the

\$17,500 that he received from SBA, and that either a larger loan from SBA or another one—which SBA has denied—might have enabled him to keep his business.

Company: Auto Dealer Tech Support, Nashville, TN

Interviewee: Reservist Owner

Discussion. The owner worked for a large company until about 5 years ago, when (with his employer's encouragement) he became an independent provider of technical support for auto dealers. His call to active service essentially decimated his business: he was not able to replace himself, since his expertise stemmed from his experience with his clients' needs and there was no one else with that experience. As a result, he lost customers and perhaps \$100,000 worth of business, although his SBA loan of \$27,500 did allow him to avoid defaulting on his debts. He is currently on active duty at Ft. Benning, where he is able to spend 10–20 hours a week on his clients and his business. His long-run plan (which was to have begun in January 2004, when his active tour was due to end) is to rebuild the business, about which he remains optimistic.

Company: Orthopedics Practice, Portland, OR

Interviewee: Office Manager

Discussion. This orthopedic practice was owned and operated by two doctors, one of whom was activated for Iraq. In preparing their SBA loan application, the doctors estimated the loss of practice that would result from the reservists anticipated 6-month absence. Ultimately, the practice was able to find a partial replacement for the reservist—a semi-retired orthopedist who had been associated with the two doctors in an earlier version of the practice. There were no significant costs associated with finding the replacement or, indeed, with paying him, since his patient load essentially pays his salary. Overall, however, the practice continues to experience losses because the replacement doctor does not perform surgery, and some two-thirds of the practice's workload consists of surgical procedures. The office manager, whom we interviewed, was not familiar with the provisions of USERRA but noted that the practice had been able to suspend the reservist doctor's health care coverage for 6 months during his absence, thus saving premium costs. She did not know how the practice would handle his retirement account or how much it would supplement his military pay. She did not anticipate any long-term effects from his activation, expecting that the practice would eventually return to normal after his release from active duty and perhaps some phased recovery of patient workload.

Company: Office Products, Bismarck, ND

Interviewee: Owner

Discussion. The owner has about 15 employees. One of them, his service manager, was called to active duty in 2001. The owner estimates that he lost about \$70,000 in business during the activation. He did not hire a full-time replacement, but shifted some of the workload to other personnel at the cost of additional payroll, sent some employees through training at additional cost, and hired some part-time personnel to take up some of the slack. In addition to incurring these financial costs, he found that his employees had to forgo some of the cross-training that they would have received from the service manager on the job. The owner was vaguely cognizant of the existence of USERRA, but he did not have cost numbers available; those would be handled by his accountant. He did think, however, that his company had paid all of the family health premiums for the service manager during his absence (over \$500 per month) and that it had made up some of the difference between his civilian and military pay. In the longer run—the service manager has been back on the job for nearly a year—he still has not been able to recoup all of the business lost during the activation. And since other employees picked up some of the service manager’s responsibilities, the owner has had to reassign the man to other tasks to keep him fully employed. Jones was critical of the SBA loan program, which lent him about \$40,000, arguing that at least some of the loan and/or interest should be forgiven, as was done when the city of Grand Forks provided loans to businesses hurt by the flooding of a few years ago. Despite the problems created for his company by activation of his service manager, the owner said that he would not refuse to hire a person just because the applicant was a member of the Guard or Reserve. Rather, he noted there are positive aspects to hiring reservists as well as the negative of potential activation.

Company: Contractor/Carpenter, Madison, WI

Interviewee: Wife of reservist/part owner

Discussion. The activated reservist was a carpenter and contractor who was self-employed, in business with a less experienced carpenter as his partner. During his period of active duty the business essentially shut down, as the junior carpenter was not able to perform the work by himself and it was not feasible to find a senior man as a replacement. Since the reservist’s return—he has been back from active duty for a year—he has resumed his business, but his wife said that it took a good 6 months for him to find any new work, and even after a year the business is not back to its previous level. In her words, they are scraping by. The experience of being recalled to active duty has

not yet caused the reservist to end his Reserve affiliation, but his wife says that he is leaning in that direction because he does not want to go through a similar experience.

Appendix B

DRAFT EMPLOYER QUESTIONNAIRE

The Department of Defense is concerned about the possible effects on employers when their military reservist personnel are called to active duty. As a first step toward determining the impact of employing military reservists, this questionnaire asks you to provide information about your company's experience with employing military reservists.¹ All information you provide will be held in strict confidentiality. Responses from individual companies will be used only to compile grouped statistics; no information on individual companies will be released.

There are four sections to this questionnaire. The first asks about your company's policies with respect to the pay and benefits of reservists who are called to active duty. The second deals with the replacement of activated reservists, and the third addresses longer-run issues of morale and productivity. The final section asks about positive or negative aspects of military reservists as employees. Where possible, please provide financial information if it is relevant; if accurate financial information is not available, please provide estimates (noting that the data are estimates) or a non-financial description if you cannot estimate financial effects.

I. Pay and Benefits

Retirement Benefits. When a reservist employee leaves active duty and returns to work with the same employer, the employer must contribute to the reservist's retirement account what the employer would have contributed had the reservist not been called up. To receive this benefit, the reservist must, upon his return, make up his matching contributions, if any are called for under the company's retirement plan. Some companies with such retirement plans elect to provide the employee's matching contribution for some period during activation.

-- Does your company have a matching plan?

¹ This draft survey questionnaire does not include questions about the employer's business, size, and the reservist's specific job. This information will be obtained from OSD's Reserve employer database.

- If so, do you contribute any portion of the employee's share during his period of active service?
- If you do, what portion do you contribute, and for how long?
- What is the average cost, expressed either in dollars or as a percentage of salary?

Health Benefits. An employer must maintain an activated employee on the rolls of the company health plan for periods of active service of up to 30 days. Some companies elect to maintain health care coverage for their employees for longer periods.

- Does your company provide health care coverage for employees activated for longer than 30 days?
- If so, for how long do you continue coverage?
- Do you provide full premium payment during that period?
- If not, do you permit employees to remain covered if they elect to pay some portion of the company's premium?
- If you do, what portion are they required to pay?
- What is the resulting cost to your company, expressed either in dollars or as a percentage of the employee's salary?

Pay During Activation. When they are called to active duty, reservists are paid according to their military rank and seniority. Their military pay may fall short of their civilian salaries, and some companies elect to pay their employees a portion of the difference during the period of activation.

- Does your company pay any portion of the difference between a reservist's civilian and military pay?
- If so, what portion, and for how long?
- What is the average cost per employee to your company?

Guaranteed Return. After their completion of active service, employees are entitled to return to their previous jobs and to receive accumulated seniority raises and promotions.

- Under your company's pay policies, what is the cost of providing these benefits to employees?

- For example, what is the average annual seniority pay raise, either in dollars or as a percentage of pay?
- At what intervals (for example, 6 months, 1 year, or 2 years) do employees receive seniority-based promotions, and what is the average pay increase associated with a promotion?

II. *Replacing Activated Reservists*

Uncertainty About Departure. A company's reaction to the activation of a reservist may depend on how much notice it has about the reservist's departure. If a company has considerable advance warning, it may be able to plan for workload interruptions, train other personnel to pick up some of the reservist's workload, or consider hiring temporary replacements.

- How much advance notice did your company have about your reservist's forthcoming activation?
- Were you able to plan for your reservist's departure, or did the activation impose costs in the form of disruption of production, unanticipated reassignment of work, or other consequences?
- How much advance notice would you have needed to minimize such adverse effects of the reservist's activation?
- If your reservist has returned from active duty, how much advance notice did you have of the date of his or her return? Was that sufficient to plan for the reservist's reintegration into your workforce? If not, how much advance notice would you have needed to make such plans?

Hiring Temporary Replacements. Although reservists are guaranteed the right to reemployment, a company may elect to replace them during their periods of active duty. In doing so, the company may incur various costs associated with the search for candidates and the hiring process itself.

- If your company has hired temporary replacement personnel, what are the average costs per replacement for search costs such as advertising, processing applications, and fees paid to employment agencies?
- Did you have to hire additional administrative personnel to deal with the demands of processing applications?

- If not, did your existing staff incur additional workload, perhaps including overtime, to process applications? Please include if possible an estimate of these costs.

Training Replacement Personnel. Depending on the skill level of the reservist and the requirements of his position, companies may have to provide either on-the-job or classroom training for replacement personnel.

- If your company has used replacement personnel, what is the average cost you have incurred for training them?
- If you cannot estimate the dollar cost of on-the-job training, please provide if possible an estimate of the time required to bring a replacement up to the required skill level.
- If your replacement personnel required security clearances or other special qualifications, please provide an estimate of the cost of obtaining the required clearances or the additional cost of hiring people with the required qualifications.

Pay and Benefits. Depending on the source of replacement personnel, companies may incur costs in excess of the pay and benefits of the activated reservists. For example, temporary personnel hired through employment agencies may be paid more than permanent staff in equivalent positions, and agencies may charge continuing fees as a percentage of salary in lieu of the direct payment of benefits.

- If your company has hired temporary replacement personnel, please estimate the per capita difference in employee cost between the replacements and the activated reservists.

Productivity. If reservists are not replaced, their loss presumably will affect a company's productivity. Even if replacements are hired, productivity may fall, at least temporarily.

- Please assess the effect on your company's productivity from the loss of activated reservists. Some ways to measure the change in productivity might include lost sales, delays in production, or reduced profits.
- If your company hired replacements, please estimate the difference in productivity between the reservists and the replacement personnel,

including any difference that diminished or disappeared over time as the replacement workers' skills or performance improved.

III. Long-Run Effects of Activating Reservists

Regaining Lost Business and Productivity. Activation of key employees may affect a company's overall ability to compete in the marketplace.

- Did your company experience any long-run loss of profitability related to the activation of reservists?
- If your reservists have returned from active duty, how long after their return did it take for them to return to their previous level of productivity?
- How long did it take your company to regain its previous level of output, revenue, or profitability? Please give as much detail as possible.

Effects on Other Employees. Companies that do not replace activated reservists may find that the remaining personnel experience increased workload. Indeed, such increases may occur even if replacement personnel are hired. Workload increases can impose dollar costs (for example, overtime pay) and non-dollar ones (lower quality, higher accident rate).

- Has your company experienced any such effects? Please discuss both monetary and non-monetary costs.

Employee Morale. By placing additional burdens on other employees, activation of reservists might affect the long-run stability and morale of a company's workforce. These effects might appear in the form of higher employee turnover or lower productivity.

- Has your company experienced either of these consequences, or have there been any other effects on your workforce that you attribute to the activation of reservist personnel?

IV. Experience with Reservist Employees

Some companies find that despite the possibility of their being called to active duty, military reservists are a desirable pool of potential employees. Among the positive factors associated with reservists are their experience with military discipline, the value of training received in the military, possession of character traits useful for both military service and civilian employment, and commitment to family, community, and country.

- Has your experience with reservist employees been generally better, worse, or about the same as with non-reservists?
- Do the intangible aspects and personal qualities of reservist employees outweigh whatever disadvantages are associated with their reserve commitments?
- What steps could the Department of Defense take to alleviate problems associated with the military reserve service of your employees?

Please add any additional comments you may have about the effects that the activation of reserve personnel has had on your company, other than those already included in your responses to the questions above. Thank you for participating in this survey.

Appendix C

OTHER DATA ON EMPLOYER COSTS

EMPLOYER COSTS: RECENT EVIDENCE

IDA examined recent data on employer costs of benefits, with a view to estimating the cost of continuing reservists' benefits during their active duty. Except for the Reserve Component Survey, we did not find data specifically related to reservists. In some cases, however, we were able to adjust data for the characteristics of reservists. We also examine data on employer family and medical leave policies, which shed some light on the extent of pay continuation during employee leaves and the prevalence of replacement costs.

A. Distribution of Employers Offering Benefits

This section discusses the distribution of employers offering health and pension benefits. Since USERRA requires continuation of health benefits¹ for those ordered to active duty for periods of up to 1 month and of employer pension contributions based on seniority indefinitely, federally mandated employer costs are likely to be concentrated in groups of employers offering these benefits.

Employers Offering Health Benefits

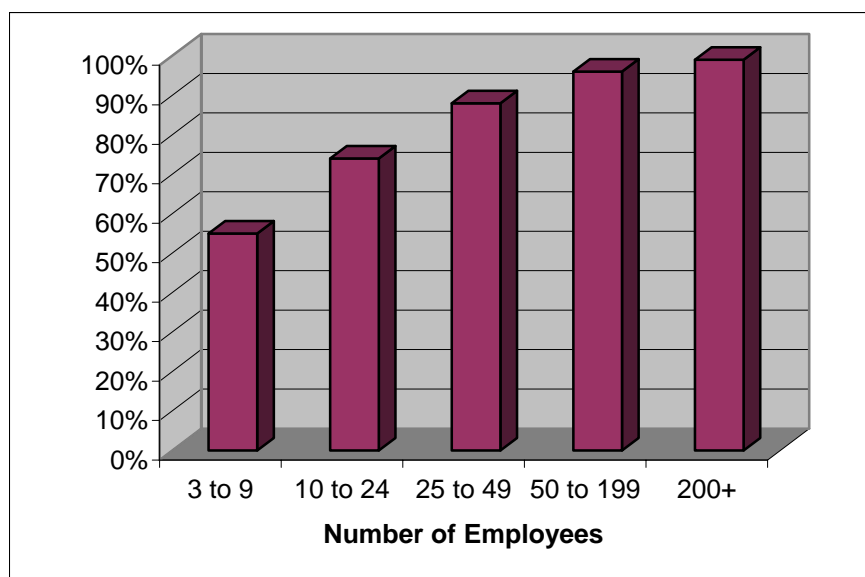
In 2001, 77.4 percent of workers age 18–64 were offered employer-based health coverage, up from 73.8 percent in 1993. In 2001, 63.5 percent of workers age 18–64 were covered by own-employer health insurance. This is up slightly from 62.9 percent in 1993.²

The likelihood of a health plan being offered varies by employer size. Only 55 percent of very small employers (3–9 employees) offer a plan, while 96 percent of those with 200 or more employees do (see Figure C-1).

The employer cost of health benefits is influenced by the rate at which employees elect to participate in the program. Table C-1, below, shows participation rates for employees in private industry using data from the 2000 National Compensation Survey.

¹ USERRA requires maintaining the premium sharing arrangement but does not mandate that the employee remain under the employer-sponsored plan.

² Employee Benefit Research Institute, *EBRI Research Highlights: Health Benefits*, EBRI Special Report SR-41, Issue Brief No. 257, May 2003.



Source: Kaiser/HRET 2002 Survey of Employer-Sponsored Health Benefits

Figure C-1. Percent of Employers Offering a Health Plan, by Number of Employees, 2002

Table C-1. Percent of Private Industry Employees Participating in an Employer-Based Health Plan, 2002 (Percent)

	All Occupations	Profess'l, tech, and related	Clerical and sales	Blue-collar and Service
All Private Industry Employees	52			
Full time	61	69	62	57
Part time	13	28	12	12
Union	75			
Non-union	49			
1-99 employees	43			
100+	61			
Full time, 1-99	56	67	60	49
Full time, 100+	67	70	66	66
Part time, 1-99	6	24	6	4
Part time, 100+	28	31	22	30

Source: Employee Benefit Research Institute, *EBRI Research Highlights*.

Over 60 percent of full-time private industry employees participate in a health plan. Professional, technical, and related workers are somewhat more likely to participate than clerical/sales and blue-collar/service workers.

In order to apply these participation rates to reservists, Table C-2 presents the distribution of drilling reservists across these employer categories. The data were tabulated from the 2000 Survey of Reserve Component Personnel (RCS).³ Applying these participation rates to the distribution of reservists across employers produces an estimate of the percentage of reservists employed in the private sector and participating in an employer-sponsored health plan, 56 percent. If we use the federal participation rate for all public sector employees, the participation rate for reservists in the public and private sectors (not self-employed) is 65 percent.

**Table C-2. Reservists in Employer-Sponsored Health Plans,
by Type and Size of Employer
(Percent)**

Employers of Reservists	Reservists	Participants in Health Plans
Public sector	36	81 ^a
Private - 1 to 99	19	43
Private - 100 to 499	13	61
Private - More than 500	32	61
Private Sector	64	56
Public and Private Sectors	100	65

Note: Percentages exclude those not employed (15 percent of all reservists) and self-employed (6 percent of all reservists)

^a Federal and postal employees only. US Office of Personnel Management, *Federal Civilian Workforce Statistics: The Fact Book, 2002 Edition*, OWI-02-02, June 2002.

Source for Distribution of Reservists by Employer: RCS

Employers Offering Pension Benefits

The USERRA law requires that when a reservist returns from active duty to their employer, the employer must make any contributions to the reservist's pension plan that would have been made had the reservist been employed during the period of military service, as long as the reservist contributes his or her share. The importance of the cost burden that this requirement imposes on employers depends on the distribution of pension benefits among reservists and their employers.

³ 2000 Survey of Reserve Component Personnel [CD-ROM] (commonly referred to as the Reserve Component Survey, or RCS). Arlington, VA: Defense Manpower Data Center [Producer and Distributor], 2002.

Data from the Current Population Survey (CPS) indicate that in 2001 61.7 percent of wage and salary workers of age 21 to 64 worked for an employer that offered a retirement plan. Of those workers, 49.8 percent were participants in an employer-sponsored retirement plan.⁴ Table C-3 presents these offer and participation percentages for workers in public sector and private sector employers, and for workers in private sector firms by firm size. The data were tabulated from the CPS by the Employee Benefit Research Institute.⁵ The offer and participation percentages are high at public and large private employers, and low at small private employers.

**Table C-3. Retirement Plan Participation EBRI CPS Data
(Percent)**

	Employer offers a Plan	Employee Participates
All (wage&salary) workers	61.70	49.80
Public sector	84.90	75.30
Private sector	57.40	45.10
Private sector (number of employees)		
1 to 99	35.95	27.80
100 to 499	62.10	46.80
500 +	76.67	60.81

The participation rates by employer type are reproduced in Table C-4. Applying these participation rates to the distribution of reservists across employers produces a rough estimate of the percentage of all reservists participating in an employer-sponsored retirement plan, 45.5 percent (see Table C-4). Because 79 percent of reservists have an employer, the percentage of *employed* reservists who participate in a retirement plan through their employer is 58 percent (45.5 percent divided by 79 percent),

⁴ Employee Benefit Research Institute (2003). *Employment-Based Retirement and Pension Plan Participation: Geographic Differences and Trends*. EBRI Issue Brief Number 256.

⁵ *Ibid.*

**Table C-4. Distribution of Reservists by Employer
(Percent)**

Employers of Reservists	Reservists	Participation (from Table C-3)	Participating Reservists
Public sector	28	75.30	21.17
Private - 1 to 99	15	27.80	4.21
Private - 100 to 499	10	46.80	4.62
Private - More than 500	<u>25</u>	60.81	<u>15.46</u>
Subtotal	79		45.46
Self-employed	6		
No Job	15		

Subtotals reflect rounding of numbers.

This estimate of the percentage of reservists in a retirement plan could be inaccurate if the characteristics of the population of reservists differ from those of the general workforce in the CPS data. Reservists do differ from the wider workforce in that they are younger: The mean age of reservists is 34. To correct for this, we take data from the EBRI on the participation percentages by age and employer and match it with the distribution of reservists by age and employer from the 2000 Survey of Reserve Component Personnel (see Table C-5). EBRI reported data by public and private employers, not by firm size. In this case, matching the participation percentages to the distribution of reservists implies that the participation percentage for all reservists is 39.6 percent. The percentage of *employed* reservists who participate in a retirement plan through their employer is 50 percent (39.6 percent divided by 79.5 percent, the percentage of reservists who have an employer). Thus, accounting for age suggests that one-half of drilling reservists have an employer-sponsored retirement plan.

Table C-5. Participation Rates and Distribution of Reservists by Age

(1) Employer Type (EBRI)	(2) Worker Participation%	(3) Employer Type (RCS)	(4) % Reservists	(5) % of Reservists Participating
Private		Private		
<20		16 - 19	3.30	0.00
21 - 24	19.10	20 - 24	9.30	1.78
25 - 34	39.80	25 - 34	17.70	7.04
35 - 44	49.90	35 - 44	14.20	7.09
45 +	52.85	45 +	6.80	3.59
Public		Public		
<20		16 - 19	0.70	0.00
21 - 24	32.40	20 - 24	1.90	0.62
25 - 34	69.50	25 - 34	7.90	5.49
35 - 44	77.50	35 - 44	10.20	7.91
45 +	81.77	45 +	7.50	6.13
		Subtotal	79.50	39.64
		Self-employed	6	0.00
		No Job	15	0.00

Employer Policies for Reservists Called to Active Duty

A survey of Fortune 500 companies by the Reserve Officers Association (ROA) reveals that large companies are providing increasingly generous benefits for active duty reservist employees.⁶ Of the 151 companies that answered the question about pay, 13 provide full salary for periods ranging from 1 year to the duration; one provides full salary for 10 workdays; 13 provide salary plus differential; 105 provide differential; two have uncertain or varying policies; and 17 provide no salary or differential. Many companies have instituted more generous policies for call-ups related to the war on terrorism. However, 41 of these companies do not extend salary or differential to volunteers.

For health benefits, all but 16 of the survey respondents have more generous policies than USERRA requires.

The larger companies tend to have more generous policies. Of the 100 largest companies, all 45 respondents provide either full salary or differential, except for Wells Fargo, #64, which decides on a case-by-case basis. Volunteers are excluded, however, for 17 of the largest companies.

⁶ Reserve Officers Association of the United States, "Corporate Response to Reserve Call-Up," *The Officer*, January/February 2003.

These survey results should be interpreted cautiously. It may not be appropriate to extrapolate the results to the entire Fortune 500, because companies without benefits beyond those required by USERRA may be less likely to respond to the survey. However, there is an upward trend in the percentage of respondents providing pay differentials (Table C-6). Certainly, the number of companies that go beyond USERRA requirements appears to be substantial.

Table C-6. Trends in Responses to ROA Survey

Survey Year	Number with Differential	% with Differential	Number with No Coverage	% with No Coverage	Number of Respondents
2001	53	45	30	25	119
2002	75	57	19	14	132
2003	105	68	17	11	154

Source: Reserve Officers Association of the United States

B. Cost of Benefits

Data on the costs of employer-provided benefits are collected by the Bureau of Labor Statistics as part of the National Compensation Survey (NCS). The BLS then publishes tabulations of these data, which include: ⁷

- Average benefit cost per hour worked for all civilian workers
- Cost by type of benefit
- Cost by type of employer (private industry, state, and local government)
- Several breakouts within private industry
 - o Goods producing vs. service producing
 - o White-collar, blue-collar, and service occupations
 - o Northeast, South, Midwest, West
 - o Union vs. non-union
 - o Size of establishment (1–99, 100–499, 500+)

The data cover all workers, but there are some separate tabulations for full-time and part-time workers. These can be very useful, because the benefits offered by employers are mainly concentrated on full-time workers.

⁷ Bureau of Labor Statistics, Employer Costs for Employee Compensation, News Release: Wednesday, June 11, 2003.

Some definitions:

- Private industry does not include the self-employed, farm workers, and private household workers.
- The public sector includes only state and local employees; it omits federal employees.
- Pension benefits have the potential to be particularly costly, because USERRA mandates continuation of benefits based on seniority. Health benefits, by contrast, need be continued only for 30 days.

Pension Benefits

The tabulations provide dollar costs per hour worked for retirement benefits. However, these costs are averaged over all workers, including those who did not receive such benefits. Therefore the data understate the costs for those workers who actually participate in a retirement plan. We can make a rough correction for this effect by dividing the reported cost per hour by the percentage of workers participating in a retirement plan.

Table C-7 presents such a calculation. The first column reports the participation percentages by employer type from the CPS data in Table C-3. The second column reports the cost per hour of retirement benefits from Employer Costs for Employee Compensation (ECEC). The third column calculates the average cost per hour for a participating worker by dividing the reported cost by the participation. The fourth column presents the implied monthly costs for a participating worker. It must be noted that the participation percentage for public sector employers is defined over federal, state, and local employers, whereas the cost per hour for public sector employers is defined over just state and local employers. Thus, the costs for public sector workers may be misstated if federal benefit costs differ from those of state and local government agencies. As reported, the cost of 1 month's retirement plan contributions for a participating employee ranges from \$244 at a medium-sized firm to \$426 at a government employer.

Table C-7. Pension Benefit Participation and Costs

	EBRI CPS Data		BLS ECEC Data	
	Costs for All Workers		Imputed Costs for Participating Workers:	
	Employee Participation Rate %	Employer Cost / Hour	Employer Cost / hour	Cost of One Month
All wage & salary workers	49.80	0.85	1.71	295.85
Public sector*	75.30	1.85	2.46	425.85
All private sector	45.10	0.67	1.49	257.50
Private sector (number of employees)				
1 to 99	27.80	0.42	1.51	261.90
100 to 499	46.80	0.66	1.41	244.44
500 +	60.81	1.29	2.12	367.72

* Public sector cost data from the ECEC are for state and local employees only. Cost for a typical month for federal employees in the Federal Employees Retirement System (FERS) is estimated to be \$441 (see Section B.3).

In order to apply these costs to reservists, Table C-8 presents the distribution of drilling reservists across these employer categories along with the participation percentages and costs from Table C-7. The reservist data were tabulated from the 2000 Survey of Reserve Component Personnel. Averaging the costs by the participation and distribution of reservists across employers yields a rough estimate for the cost per hour of retirement benefits for those reservists that participate in an employer-sponsored plan of \$2.15. This implies that the deployment of a reservist with an employer-provided retirement plan costs that employer \$372 per month on average in mandated retirement plan contributions.

Table C-8. The Distribution of Reservists and Retirement Plan Participation and Costs

Employers of Reservists	% of Reservists*	% Participation (from Table C-7)	Imputed cost / hour (\$) (from Table C-7)	Cost of one month (\$)
Public sector	28	75.30	2.46	425.85
Private – 1 to 99	15	27.80	1.51	261.90
Private – 100 to 499	10	46.80	1.41	244.44
Private – More than 500	25	60.81	2.12	367.72
Self-employed	6			
No Job	15			

* RCS data.

Health Benefits

For health benefits, we are able to estimate average monthly employer cost from two different sources that give similar results. The cost of single coverage is about \$215 per month. An employer typically pays \$489 to \$592 per month for an employee with family coverage, depending on the options offered. The lower figure is typical of employers who offer only two options—single and family, while the higher figure applies to employers who offer single, employee plus one, and family options.

The 2003 Towers Perrin Health Care Cost Survey (Table C-9) provides information on the average monthly cost of plans and the employer's share of that cost, by type of plan, and the Kaiser/HRET survey (Table C-10) provides average annual employer costs, which we converted to monthly for comparison. Towers Perrin surveyed 358 private employers (both for-profit and nonprofit) with 4.6 million employees with health coverage. The Kaiser/HRET survey includes 3,262 randomly selected public and private employers.

Table C-9. Average Monthly Employer Cost of Health Benefits, by Type of Plan, using Towers Perrin Data

	Average Monthly Cost, 2003	Employer Share (%)	Average Monthly Employer Cost (\$)
Employee only	263.00	80.67	212.16
Employee plus one	538.00	77.76	418.35
Family	762.00	77.76	592.53

Source: 2003 Towers Perrin Health Case Cost Survey.

**Table C-10. Average Monthly Employer Cost of Health Benefits,
by Type of Plan, Using Kaiser/HRET Data**

Average Annual Cost, 2002 (\$)		Average Monthly Employer Cost (\$)
Single	2,606.00	217.17
Family	5,870.00	489.17

Source: Kaiser/HRET 2002 Survey of Employer-Sponsored Health Benefits

Federal Employees Benefit Costs

Using data from OPM,⁸ we examined the cost of benefits for drilling reservists who are federal employees. Overwhelmingly, we expect drilling reservists to be in the newer of the two federal retirement systems, Federal Employees Retirement System. FERS requires agency contributions of 10.7 percent of basic pay. We obtained the basic pay for FERS employees by multiplying basic pay by the proportion of total employees who are in FERS, 60.65 percent. The result was the government's cost for FERS for a typical month, \$441.

The federal government spent \$8.76 billion to provide health benefits for 2,198,895 enrolled employees.⁹ Thus, the average annual cost is \$3,984 per enrollee, or \$332 for a typical month of coverage.

Data on Employer Costs from the Family and Medical Leave Act Survey

Under the provisions of USERRA, the military activation of a reservist employee involves federally mandated job-protected unpaid leave from the reservist's employer. Another federal law, the Family and Medical Leave Act (FMLA) of 1993, requires certain covered establishments with 50 or more employees to provide up to 12 weeks of job-protected unpaid leave per year to employees for the care of a new child or sick family member. The Department of Labor (DoL) conducted surveys in 1995 and 2000 to determine the impact of this law on employers and employees. The data collected on the costs and effects of job-protected family leave may also be relevant to the case of job-protected military leave and can provide some insight into the replacement and

⁸ U.S. Office of Personnel Management, *Federal Civilian Workforce Statistics: Work Years and Personnel Costs, FY2001*, September 2003, <http://www.opm.gov/feddata/html/wypc.asp>.

⁹ Ibid. and U.S. Office of Personnel Management, *Federal Civilian Workforce Statistics: The Fact Book, 2002 Edition*, OWI-02-02, June 2002.

long-run productivity costs of activation. The results of the surveys are collected in a DoL special report.¹⁰

Table C-11, reproduced from the DoL report, lists establishments' reports of the FMLA on employee and business performance. For every category of performance, the majority answer is that performance was unaffected by FMLA. It is notable, however, that a much greater percentage of employers report a negative affect of FMLA on business productivity, profitability, and growth than report a positive effect. Large employers (those with greater than 250 employees) are more likely to report negative effects on productivity and profitability. Smaller employers (those with 250 or fewer employees) are more likely to report a negative effect on growth. For the case of employee productivity, the percentage of firms reporting a negative effect is close to that reporting a positive effect, but the negative effect is larger for larger firms. These data suggest that the long-run costs of job-protected leave are not spread evenly across employers. A substantial minority of employers will experience these costs.

The FMLA requires employers to continue health insurance coverage for employees on family and medical leave on the same terms as if they were working. This is similar to the provision in USERRA that coverage is continued on these terms for activations under 30 days. Table C-12 presents survey data on the change in employers' costs since they were covered by FMLA. The categories of cost are administrative costs, the benefit costs due to the above mandate, and the replacement costs of hiring and training temporary workers. A slight majority of all employers and a large majority of large employers report some increase in administrative costs. Replacement costs for 34 percent employers report some increase and again large employers are more likely to incur these costs. Again, the costs appear to be spread unevenly.

¹⁰ David Cantor et al. *Balancing the Needs of Families and Employers: The Family and Medical Leave Surveys, 2000 Update*, Department of Labor, 2001 <http://www.dol.gov/asp/fmla/main2000.htm>.

**Table C-11. Effects of Complying with FMLA on Business and
Employee Performance by Establishment Size
(Percent)**

	Covered Establishments With:		
	<u>1–250 Employees</u>	<u>251+ Employees</u>	<u>All Covered Establishments</u>
Business Effects			
Productivity			
Positive effect	6.7	14.3	7.1
Negative effect	15.7	26.1	16.3
No noticeable effect	77.6	59.6	76.5
Profitability			
Positive effect	2.5	4.6	2.6
Negative effect	9.0	23.5	9.8
No noticeable effect	88.6	71.9	87.6
Growth			
Positive effect	2.5	4.1	2.6
Negative effect	10.0	4.9	9.7
No noticeable effect	87.5	91.0	87.7
Employee Effects			
Productivity			
Positive effect	15.9	14.1	15.8
Negative effect	16.9	22.2	17.2
No noticeable effect	67.2	63.8	67.0

Source: Cantor, *Balancing the Needs of Families and Employers*, Table A2-6.12.

**Table C-12. Changes in Costs Due to FMLA in Past 18 Months by Size: 2000 Survey
(Percent)**

	Covered Establishments With:		
	<u>1–250 Employees</u>	<u>251+ Employees</u>	<u>All Covered Establishments</u>
Administrative Costs			
No increase	50.2	24.0	48.6
Small increase	40.5	41.2	40.6
Moderate increase	8.5	28.6	9.7
Large increase	--	6.2	1.2
Cost of Continuing Benefits During Leave (e.g., health plans)			
No increase	65.0	43.9	63.7
Small increase	25.2	23.8	25.1
Moderate increase	9.0	31.6	10.3
Large increase	--	--	0.8%
Hiring/Training Costs			
No increase	67.1	48.3	65.9
Small increase	26.6	28.9	26.8
Moderate increase	5.7	20.4	6.6
Large increase	--	2.4	0.7

Source: Cantor, *Balancing the Needs of Families and Employers*, Table A2-6.12.

Table C-13 provides further insight into the issue of replacement costs. The table lists the percentages of employers that used a particular method to cover the work of an employee who was on leave. Almost all employers had reassigned work to other employees. This practice does not incur replacement costs but may incur costs in terms of employee morale. A large minority of firms hired a temporary replacement, and large firms were more likely to do so. Thus, many firms will incur replacement costs, but not all will.

Table C-13. Methods Used to Cover Work When Employees Take FMLA Leave, Covered Establishments by Size: 2000 Survey (Percent)

	Covered Establishments With: ^a		
	<u>1-250 Employees</u>	<u>251+ Employees</u>	<u>All Covered Establishments</u>
Assign work temporarily to other employees	98.2	99.1	98.3
Hire an outside temporary replacement ^a	39.8	68.5	41.3
Hire a permanent replacement	4.3	6.6	4.4
Put work on hold until the employee returns from leave	15.1	23.9	15.5
Have the employee perform some work while on leave ^b	8.7	13.3	9.0
Cover work some other way	10.9	5.2	10.6

Note: Percentages do not total to 100 percent because respondent could select more than one.

^a Difference between size categories is significant at $p < .05$.

^b Difference between size categories is significant at $p < .10$.

Source: Cantor, *Balancing the Needs of Families and Employers*, Table A2-6.6.

Interestingly, fewer establishments not covered by the FMLA (smaller employers) used the method of assigning work temporarily to others (86.2 percent vs. 98.3 percent of covered establishments) (see Table C-14). Other commonly used methods in non-covered establishments include putting the work on hold (31.3 percent) and having the employee perform some work while on leave (21.7 percent). A greater percentage of non-covered establishments use these two methods, compared with covered establishments.¹¹

¹¹ Cantor, *Balancing the Needs of Families and Employers*, Chapter 7.

**Table 14. Methods Used to Cover Work When an Employee Takes Leave
for a Week or Longer by Coverage Status: 2000 Survey
(Percent)**

Establishment Covers Leave By:	Covered Establishments	Non-covered Establishments	All Establishments
Assigning work temporarily to other employees**	98.3	86.2	87.5
Hiring an outside temporary replacement	41.3	32.9	33.8
Hiring a permanent replacement	4.4	7.3	6.9
Putting work on hold until the employee returns from leave ^a	15.5	31.3	29.6
Having the employee perform some work while on leave**	9.0	21.7	20.3
Some other method	10.6	9.6	9.7

Note: Percents do not total to 100 percent because a respondent could answer "yes" to more than one source.

^a Difference between covered and non-covered establishments is significant at $p < .05$.

Source: Cantor, *Balancing the Needs of Families and Employers*, Table A2-7.4.

In some respects, non-covered establishments have more generous policies than those covered by FMLA. Proportionately more non-covered establishments continue either full or partial pay for employees taking leave for FMLA reasons (Table C-15). However, non-covered establishments are less likely than small covered establishments (50–99 employees) to continue benefits such as employer pension contributions during the paid or unpaid leave.

**Table C-15. Continuation of Pay During Leave in Small Establishments by FMLA Coverage
Subgroup Status: Reasons for Which Pay is Continued: 2000 Survey
(Percent)**

Establishment Continues Pay During Leave For:	Covered Establishments with 50–99 Employees	Non-covered Establishments with 25–49 Employees
Parents to Care for Newborn		
Full pay	19.8	26.5
Partial pay	4.1	14.4
Depends on circumstances	21.0	25.5
No Pay	55.1	33.6
Parents for Adoption or Foster Care Placement		
Full pay	15.3	20.3
Partial pay	2.7	--
Depends on circumstances	20.7	17.8
No Pay	61.4	48.6
Employee's Own Serious Health Condition		
Full pay	37.8	31.0
Partial pay	10.0	16.6
Depends on circumstances	22.5	29.1
No Pay	29.7	23.3
Mother's Maternity-Related Reasons		
Full pay	32.3	31.9
Partial pay	10.2	13.0
Depends on circumstances	19.4	25.8
No Pay	38.1	29.3
Care of Child, Spouse, or Parent for Serious Health Condition		
Full pay	22.0	25.7
Partial pay	--	11.6
Depends on circumstances	21.8	28.7
No Pay	53.9	34.0

Notes: Percentages may not total to 100 percent due to rounding—indicates fewer than 10 unweighted cases
Source: Cantor, *Balancing the Needs of Families and Employers*, Table A2-7.17.

C. Implications for the Study

The ECEC data are comprehensive enough that we should consider using these categories and definitions in the Reserve employer survey. This would allow us to compare the average benefit costs per hour worked among employers of reservists with these data. If the average costs to reservist employers is similar to that of employers generally, we could argue for using the ECEC benefit costs as proxies for any missing cost categories.

We have developed estimates for the monthly costs of continuing employer contributions to pension plans and health benefits that we can use as benchmarks for the employer survey. An employer providing the minimum benefit mandated by USERRA will spend far more on pension contributions (which must be continued indefinitely) than on the continuation of health benefits (which must be continued for only 1 month).

Evidence from establishments not covered by the FMLA show that a significant number voluntarily continue full or partial pay when leave is taken for FMLA reasons. If small establishments not covered by USERRA follow similar policies for pay during reserve duty, voluntary costs to such employers may be significant, and the employer survey should try to identify them.

Appendix D
METHODOLOGY OF THE EMPLOYER COST SURVEY:
LESSONS LEARNED FROM THE SURVEY OF
SMALL BUSINESS FINANCES

The National Opinion Research Council (NORC) conducted the 1998 Survey of Small Business Finances (SSBF) for the Federal Reserve Board (FRB). The purpose of the survey was to gather information about the financial behavior of firms with fewer than 500 employees, and about the use of financial services and financial service providers by those firms.¹ To this end, the survey solicited dollar amounts from the firms for balance sheet and income statement items and for bank account, credit, loan, and lease balances. The experience of NORC in conducting this survey is relevant to the proposed Reserve employer cost survey, which would also require soliciting detailed information including dollar amounts from many small businesses.

The sample of small businesses was drawn from Dun and Bradstreet. NORC first administered a screener questionnaire to the businesses in order to confirm their eligibility for the study and collect demographic information. NORC mailed a letter (from Alan Greenspan) to each business, explaining the survey and inviting them to participate, and telephoned them within a few days to administer the questionnaire. The main interview was administered in a similar way. NORC then mailed a package to each business that contained brochures describing the survey, NORC, and the FRB and a worksheet for recording the dollar amounts that would be required in the interview. The package was followed up with a telephone call to complete the interview. The worksheet described the dollar information required and provided the line number where the income statement information could be found on the business' tax form. The remaining information would have been available from the firm's various bank statements and its balance sheet.

¹ National Opinion Research Council, *The 1998 Survey of Small Business Finance: Methodology Report 2001*, retrieved 10/3/2003 from <http://www.federalreserve.gov/pubs/oss/oss3/ssbf98/ssbf98home.html - ssbf98results>.

Despite the apparently straightforward nature of the information requested, the response rate to the survey was low. Only 33 percent of the sample resulted in completed cases, while 45 percent of the businesses refused to cooperate. On average, 19 telephone calls were placed to each firm in the survey following the mailing. One-half of the completed cases returned their worksheet by mail, as requested. An attempt to convert refusals by sending field representatives to the firms was completely unsuccessful. An attempt to raise the response rate by offering financial incentives to businesses, such as mailing a \$20 check along with the interview package, was also unsuccessful in increasing response rate. Some businesses complained that they would have to pay their accountants to fill out the worksheet. NORC created a fund to reimburse these businesses for this cost, but again failed to increase response.

The high degree of effort required and low response rate in the SSBF provides an indicator of the challenges that will be faced by a survey of Reserve employer costs. In fact, the data-gathering requirements for the employer cost survey are significantly more ambitious than those of the SSBF. While the dollar amounts solicited in the SSBF should have been available to businesses owners by simply looking up the figure on a tax form or bank statement, the Reserve employer survey would require the economic calculation of dollar costs from such factors as search costs, lost sales, and even lost morale. For many businesses, these calculations would require a significant amount of effort or assistance from cost accounting professionals. Employers may be unwilling to devote the necessary time and resources to prepare a survey response. Thus, the response rate to the proposed survey could be very low. A low response rate could also give rise to response bias in the survey. Those employers that have the highest costs of mobilization and the most concern about these costs could be the most likely to expend the effort to calculate them and respond to the survey, if they believe it will result in policy changes that will mitigate their costs.

The most important lessons from the SSBF example are as follows:

1. The administration of an employer cost survey will pose important challenges, and because of this the task should be assigned to an organization with a high degree of expertise in survey methodology.
2. The survey should adopt the method of mailing a worksheet or questionnaire and following up with phone calls, in order to give employers time to calculate their costs.

3. A simplified survey should be considered that would offer respondents multiple choice dollar ranges for the various costs. Such a survey would be much easier for an employer to answer and would provide guidance on what the important cost components were. This survey could be fielded prior to attempting a more detailed survey.

Appendix E

GLOSSARY

BLS	Bureau of Labor Statistics
CONUS	Continental United States
CPS	Current Population Survey
DoL	Department of Labor
EBRI	Employment Benefit Research Institute
ECEC	Employer Costs for Employee Compensation
FERS	Federal Employees Retirement System
FMLA	Family and Medical Leave Act
FRB	Federal Reserve Board
HRET	Health Research and Educational Trust of New Jersey
IDA	Institute for Defense Analyses
MREIDL	Military Reservist Economic Impact Disaster Loan
NCESGR	National Committee for Employer Support of the Guard and Reserve
NORC	National Opinion Research Council
OPM	Office of Personnel Management
OSD	Office of the Secretary of Defense
RCS	<i>2000 Survey of Reserve Component Personnel</i> (commonly referred to as the Reserve Component Survey)
ROA	Reserve Officers Association
SBA	Small Business Administration
SSBF	Survey of Small Business Finances
USERRA	Uniformed Services Employment and Reemployment Rights Act

REPORT DOCUMENTATION PAGE				Form Approved OMB No. 0704-0188	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing this collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to Department of Defense, Washington Headquarters Services, Directorate for Information Operations and Reports (0704-0188), 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to any penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number. PLEASE DO NOT RETURN YOUR FORM TO THE ABOVE ADDRESS.					
1. REPORT DATE (DD-MM-YY) December 2004		2. REPORT TYPE Final		3. DATES COVERED (From - To)	
4. TITLE AND SUBTITLE Analysis of Employer Costs from Reserve Component Mobilization				5a. CONTRACT NO. DASW01 04 C 0003	
				5b. GRANT NO.	
				5c. PROGRAM ELEMENT NO(S).	
6. AUTHOR(S) Colin M. Doyle, Glenn A. Gotz, Neil M. Singer, Karen W. Tyson				5d. PROJECT NO.	
				5e. TASK NO. BE-6-2308	
				5f. WORK UNIT NO.	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Institute for Defense Analyses 4850 Mark Center Drive Alexandria, VA 22311-1882				8. PERFORMING ORGANIZATION REPORT NO. IDA Paper P-3872	
9. SPONSORING / MONITORING AGENCY NAME(S) AND ADDRESS(ES) Office of the Assistant Secretary of Defense (Reserve Affairs) Pentagon Washington, DC 20301				10. SPONSOR'S / MONITOR'S ACRONYM(S) OASD(RA)	
				11. SPONSOR'S / MONITOR'S REPORT NO(S).	
12. DISTRIBUTION / AVAILABILITY STATEMENT Approved for public release; distribution unlimited.					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT This paper examines the available information about the costs that mobilizations impose on employers. It is likely that the cost consequences are different for small employers than for large ones. Evidence is presented suggesting that the most significant costs for small employers are related to lost productivity and sales rather than to the costs associated with the requirements imposed by the Uniformed Services Employment and Reemployment Rights Act (USERRA). The paper recommends a survey of employers to fill out gaps in available information and discusses rationales and options for mitigating costs.					
15. SUBJECT TERMS National Guard and Reserve, reserves, employers, mobilization, cost					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT UU	18. NO. OF PAGES 72	19a. NAME OF RESPONSIBLE PERSON Col. James Scott
a. REPORT U	b. ABSTRACT U	c. THIS PAGE U			19b. TELEPHONE NUMBER (Include Area Code)

